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Competition States on Europe's Periphery: Race to the Bottom and to the Top

Višnja Vukov

Thesis submitted for assessment with a view to
obtaining the degree of Doctor of Political and Social Sciences
of the European University Institute

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Abstract

The thesis deals with the transformations of capitalist states in Europe in the context of increased economic transnationalisation and explores the different strategies that states develop to increase their competitiveness and attract capital, thereby improving the profile of insertion of their economies in the global and regional markets. Starting from the premise that the increased economic integration apparent in market liberalizations, the intensification of trade, the transnationalisation of production and the emergence of transnational financial markets exert pressures on states to reorient their economic and social policies towards the goal of increasing competitiveness and transforming themselves into so-called Competition States, the thesis examines the extent to which this state reorientation has been apparent in Europe and whether it has led to the emergence of unique or varied types of Competition States.

The main argument is that, first, pressures for state restructuring vary among European states, with the Eurozone members being much less exposed to the pressures of the international financial markets and thereby much less likely to transform into Competition States and, second, those states that are exposed to such pressures respond in different ways and devise different strategies for increasing competitiveness. Based on the comparative case-studies of the Czech Republic and Slovakia as representatives of the two different types of Competition States, the thesis argues that the choice of these strategies is primarily shaped by the features of the domestic political system – more precisely, the strength or weakness of socio-economic issue divides as the main axis of competition in the political party system – rather than being determined by the position of states in the global or regional division of labour, or by their initial social and economic institutions.

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INTRODUCTION

The thesis deals with the transformations of capitalist states in Europe in the context of increased economic transnationalisation and explores the different strategies that states develop to increase their competitiveness and attract capital, thereby improving the profile of insertion of their economies in global and regional markets. The relationship between globalization or economic transnationalisation and nation-states has been a matter of heated debates in social sciences, with arguments ranging from those predicting the emergence of a 'borderless world' with the complete withering away of the state to those refuting the strength or novelty of globalization and asserting the continued primacy of national-level social and economic institutions as the main determinants shaping national socio-economic orders. This thesis enters the debate at the middle ground between these extremes. Namely, the starting point is the position advanced in international political economy and in the *regulation* approach which states that, while the state is not withering away, the increased economic integration apparent in market liberalization, intensification of trade, transnationalisation of production chains and the emergence of international financial markets still do exert pressures on states to reorient their economic and social policies towards the goal of increasing competitiveness and transforming themselves into so-called Competition States. The thesis seeks to examine the extent to which this type of state reorientation has indeed taken place in Europe and if it has led to a convergence on the unique set of policies assumed by the Competition State theory, or whether different types of state transformation and different strategies of increasing competitiveness can still be identified. The main argument, in a nutshell, is that first, economic transnationalisation *does* create serious pressures for states to reorient their economic and social policies towards the goal of increasing competitiveness; however, these pressures are much more palpable for states that have preserved one of the main traditional prerogatives of state sovereignty – namely, their national currency. With respect to the question of convergence or divergence of policies and social models in Europe in particular, the argument is thus that the Eurozone members have, up until the latest Great Recession, been much less exposed to the pressures of the international financial markets and were, therefore, much less likely to transform into Competition States. The second argument is that those states that *are* exposed still respond in different ways and devise different strategies for increasing competitiveness. In other words, although the menu of policy options available to national governments has certainly decreased compared to the period that Ruggie calls 'embedded liberalism' (Ruggie, 1982: 372), with Keynesian demand management being replaced by supply-side policies, there still *is* space for differentiation while the precise combinations of policies adopted – in other words, the distinct strategies for increasing competitiveness – remain the result of purposive political agency at the national level. More precisely, the choice of competitive strategies is primarily shaped by the features of the domestic political system and in particular political party system, rather than determined by state size, the initial position in the global or regional division of labour, sectoral structure of the economy, or the initial national-level social and economic institutions, such as varieties of capitalism or welfare state institutions.

By exploring the politics of state transformation and the rise of the Competition State, the thesis addresses three types of claims about states in transnational economy. One such claim is that globalization is making states 'wither away' and leading to a broad convergence on the liberal model, whereby states are supposed to be reduced to the minimalist night-watchman state that merely ensures property rights and oversees the functioning of the market, but withdraws from the provision of any kinds of services which are entirely left to market actors. This is the radical version of the globalization theory, apparent in management literature and, occasionally, in political economy (Ohmae, 1995; Mishra, 1999; Rodrik, 1997) and is a thesis that has already seen many critical responses, in particular coming from comparative political economists. Another strand of the literature more directly addressed by this thesis is, for its part, a more sophisticated argument positing that the state in global economy is not disappearing but is rather being transformed. This is the principal argument of the Competition State theory developed in international political economy (Stopford and Strange, 1991; Cerny, 1990) and the *regulation* school in political economy (Jessop, 2002; Brenner, 2004; Peck, 2001). Contrary to the thesis that the state is withering away, the central argument of the Competition State theory is that economic globalization is pressuring states to transform from Keynesian or Industrial Welfare States to Competition States concerned not with managing demand and redistributing economic resources through income protection and decommodification, but rather with the supply-side economic policies and recommodifying social policies. The main claim is, thus, that economic and social policies are being reoriented towards the goal of increasing economic competitiveness and attracting a better share of the world's increasingly mobile capital, thereby improving the insertion of local economy in the global markets. Although acknowledging that state transformation does not equal state shrinkage or the convergence to the *laissez-faire* model, Competition State theory still assumes that the menu of policy options left open to national governments is increasingly being reduced to a specific set of policies that all states are being pressurised to implement if they want to succeed in the global race for capital: rolling out generous investment incentives, cutting corporate taxes and shifting the generation of revenues from direct to indirect taxation, reorienting social policies from decommodification towards recommodification, establishing flexible labour markets etc. In contrast with this position and with the largely theoretical approach and ambitions of the Competition State literature, this thesis instead seeks to empirically explore whether this broad process of transformation is indeed at play by first providing the operationalization of the concept of Competition State that current theories lack and, secondly, using it in an exploratory statistical analysis designed to establish whether the policies assumed by the theory do indeed appear together and lead to the emergence of Competition States in Europe. Based on the results of the statistical analysis, the thesis argues that the policies towards increasing competitiveness, to the extent that they are apparent, actually appear in different but patterned combinations, so that in Europe we may identify two distinct strategies of state transformation leading to different types of Competition States. While the high-road strategy combines generous investment incentives and 'activist' recommodifying social policies based on increased spending on human capital, the low-road alternative combines low corporate taxes across the board, rather than specific incentives, with recommodification based primarily on selective cuts in social spending. The thesis also complements Competition State theory by explaining why these different strategies come to be adopted and demonstrating how they are conditioned primarily by domestic politics. Hence, although structural conditions of the transnational economy and increased capital mobility do present a challenge to which national governments have to adapt, as Mark Blyth powerfully argues, 'structures do not come with an instruction sheet' (Blyth, 2003: 695) so any responses to these structural pressures still depend on the prevailing ideas on the appropriate role of the state in fostering competitiveness and succeeding in the global competition for investments. Depending on the structure of the national political party system, however, a polity will be more or less likely to generate *different* ideas about the role of the state in managing economic transnationalisation – in countries with a political party system structured predominantly around socio-economic issue divides, the emergence of competing theories and ideas about competitiveness in the political arena is more likely than in the systems structured around political regime or national identity issue divides. Demonstrating how the development and adoption of different ideas and strategies for increasing competitiveness depends on the features of the political party systems, the thesis thus seeks to bridge the gap between international political economy and the political and partisan theory of state policies.

By focusing on domestic politics as the determinant of state responses to globalization, the thesis is also certainly in dialogue with comparative political economy scholarship whose main position has been that, since states respond differently to common challenges, differences among states and their social and economic policies persist even during the emergence of global markets and it is primarily domestic institutions and / or domestic politics that determine these responses. The bulk of this literature focuses primarily on the welfare state in the 'era of retrenchment' and, while earlier research typically adopted the position that politics *against* markets still matters and globalization is not reducing the role of the state in social protection (Huber and Stephens, 2001; Pierson, 2001; Garrett, 1998), later studies focusing more on welfare state transformation argued that politics *with* markets in the form of supply-side social policies is emerging across different welfare regimes but is still conditioned by pre-existing welfare state institutions or Varieties of Capitalism (Hauserman and Palier, 2008; Thelen, 2012; Obinger et. al. 2010). While acknowledging the persistence of divergence and the relevance of national-level institutions and political developments, the present thesis nevertheless departs from the usual comparative political economy approaches. First, it takes a broader view of the welfare state, examining not only narrowly understood social policies, but their patterned combinations with fiscal policies. It also shows that, rather than depending on domestic politics and institutions, the presence or absence of state overall transformations towards supply-side policies in Europe depends predominantly on their participation in the monetary union. Domestic politics and institutions thus matter primarily for the states that have remained outside of the shield of the common currency in the sense that domestic politics influence the *path* of transformation, i.e. the choice of strategy for increasing competitiveness rather than the *presence or absence* of transformation. Furthermore, by taking a broader spectrum of states than those typically examined in the mainstream political economy – notably, Western and East European states - the thesis goes beyond merely addressing cases traditionally labelled as liberal models versus those that do not converge to the liberal doctrine. Rather, it compares the transformation of two non-liberal states – one of which indeed ends up in the radically liberal, or minimalist Competition State camp, while the other experiences a different type of transformation. Hence, while earlier comparative research typically focused on the political *barriers* to the neoliberal path of reforms, the present thesis seeks to explore not only the politics of the failure of neoliberalism, but also the political conditions of its success in the institutional setting that was initially very far from the neoliberal one.

Furthermore, by arguing that domestic political agency determines the strategy for increasing competitiveness, the thesis also relates to the literature on partisan determinants of state strategies in global economy (Garrett, 1998; Boix, 1998). However, although sharing many assumptions with these approaches, it still differs in two important respects. First, it shows that partisan politics does not play out in different decommodifying policies (that would be Garrett's argument of social compensation for economic openness), but rather in different recommodifying policies. With respect to economic policies, meanwhile, it shows how parties and partisan politics matter not only for the level of *public* investment (as Boix argues) but also for the development of different policies towards increasing *private* investment. More importantly, and in contrast with both Garrett and Boix, the thesis does not take the government of left or right political parties as the main explanatory factor (assuming basic similarity of left and right positions in different countries). Instead, it looks to how political party *systems* where socio-economic issues form the main axis of competition among political parties lead to the adoption of a high-road strategy of increasing competitiveness, while the states with party competition structured around national identity or political regime issues are more likely to adopt low-road strategy for increasing competitiveness.

The focus of the thesis is thus not on politics *against* markets, but rather on different *kinds* of politics *with* markets (Streeck, 1999). This puts the present study also in dialogue with Varieties of Capitalism literature, including the standard VoC approach (Hall and Soskice, 2001; Estevez-Abe, 2001) and in particular the adaptation of VoC to East European capitalism with the concept of Dependent Market Economies (Nolke and Vliegenthart, 2009), as well as the Polanyian conceptualization of varieties of capitalism in Eastern Europe (Bohle and Greskovits, 2012). In contrast with the VoC focus on different firms' preferences in different varieties of capitalism, the thesis shows that it is the agency of domestic political actors rather than the preferences of firms that determine the differences in state strategies – apparent in the divergence of Czech Republic and Slovakia, both of which would be classified as DMEs or embedded neoliberal economies. The thesis also shares the focus on domestic political agency with the Polanyian approach to varieties of capitalism; however, it focuses more specifically on the development of states and state strategies for building transnational capitalism, which is only one aspect of the Polanyian approach, as the latter combines both state policies and economic structures and social outcomes. Furthermore, while the notion of domestic political agency remains somewhat unspecified in the Polanyian approach, where the emphasis is on differences in political elite choices at the national level rather than intra-national conflicts apparent in political party conflicts and divides, the present thesis argues that the domestic political agency that determines state strategies for building transnational capitalism should be regarded primarily in reference to political parties and party systems.

The thesis proceeds by first operationalizing the concept of Competition State and using a cluster analysis in order to see if the combinations of policies theorized by the Competition State literature do indeed appear together and whether or not they led to the convergence of European states between mid-1990s and 2007. The first part of the research establishes that, while in the mid-1990s none of the groups of European states could be described as Competition States, by 2007 some of them had indeed undergone a transformation that is roughly in line with that predicted by the Competition State theory. Nevertheless, rather than constituting a unique ideal-type, policies for increasing competitiveness actually manifest themselves in patterned combinations so that we may identify two different routes to becoming a Competition State: the high-road, combining generous investment incentives and 'activist' recommodifying social policies based on increased spending on human capital; and the low-road, which combines low corporate taxes across the board and recommodification based primarily on cuts in social spending. With the exception of Ireland, both of these strategies are however apparent only in states that, while being in the EU, have not joined the monetary union. Amongst the Eurozone members, meanwhile, countries either implement much less radical reforms (Northern states) or even go in the direction of decreasing competitiveness (Southern states) so that they actually converge over time into a single Eurozone cluster. Thus, the thesis argues that the creation of the common currency has actually decreased the pressures for state reorientation towards increasing competitiveness, while the countries outside of the Eurozone indeed develop into different types of Competition States.

The second part of the research uses qualitative case studies to explore why states adopt different strategies for increasing competitiveness. The cases selected are the Czech Republic and Slovakia, two countries that, that starting from the same point in mid-1990s, show increased divergence over time and develop into two different types of Competition States. As they share important economic, political and institutional legacies, having been part of the same state for almost a century, their divergence represents something approaching a natural experiment. Furthermore, after gaining national independence, they both attempted to build national capitalism and only turned towards outward-oriented strategies of attracting FDI and increasing competitiveness in the late 1990s. In this period both states also experienced the same type of economic transnationalisation, based predominantly on FDI in manufacturing sectors and exports of complex goods. Thus they represent almost ideal cases for the most similar case design. Other approaches, such as those focusing on the state size as the determinant of strategies in world economy (Katzenstein, 1985), varieties of transnational capitalism (Nolke and Vliegenthart, 2009), or those looking to the influence of globalization as the equalizing factor leaving little space for independent policy choices (Drahokoupil, 2009; Appel, 2011), would all expect that their strategies for increasing competitiveness would be largely the same. The same goes for theories focusing on historical institutional legacies – in particular the legacies of socialism (Inglot, 2008; Cerami, 2006; Haggard and Kaufmann, 2008). The divergence of the Czech Republic and Slovakia represents a puzzle for all of these approaches – and, for the latter, the puzzle should be framed as one of different postsocialist pathways. In contrast with this literature, the thesis does not focus on differences in postsocialist reforms or strategies – rather it focuses on divergences in their externally oriented strategies starting from a similar starting point, but this similar starting point is not their similarity during socialism, but rather the similarity of their state forms in the period of national capitalism in the 1990s. In other words, the thesis compares Czech Republic and Slovakia not as two socialist states developing different capitalisms, but rather as two capitalist states developing different externally oriented strategies. Qualitative research shows that these different strategies were indeed based on different ideas on the choice of policies for increasing competitiveness and that these ideas were formulated as central parts of the programs of political parties. In the Czech Republic – where the party system is structured around socio-economic left-right issues – both high- and low-road strategies for increasing competitiveness appeared in the late 1990s (as parts of the Social Democrats' and neoliberals' programs, respectively) with the high-road one gaining electoral victory. Meanwhile, in Slovakia – where the party system was structured around democratization and institutional accountability issues – the neoliberal low-road strategy was the only economic program for attracting FDI and increasing competitiveness. Furthermore, even after changes in governments, both of these states maintained their respective models: the strong opposition to neoliberal policies and weak government coalition in the Czech Republic prevented the slide towards the low-road; while, in Slovakia, the absence of any alternative to neoliberalism led to the preservation of low-road policies even under a populist 'left' government. Rather than simply the political colouring of the ruling parties, it is thus the features of party systems that explains the development and persistence of different strategies in these two states.

The thesis proceeds by first elaborating in more detail the theoretical contributions and debates surrounding the relation of globalization and states in contemporary political economy. The second chapter thus reviews the positions advanced by international political economy and the *regulation* school in political economy, as well as the institutional and partisan approaches developed in comparative political economy, and proposes a way of combining the two by viewing political party systems as the key factor shaping the politics of competitiveness-oriented strategies. In the third chapter I offer an operationalization of the concept of Competition State and use it in a cluster analysis of state policies in Europe, examining to what extent Western and

Eastern European states have indeed experienced this state transformation and whether it has led to convergence or divergence among European states. Statistical analysis shows that the process of transforming into a Competition State is characteristic primarily for states that have remained outside the Eurozone while membership in the common currency reduced the pressures of such state restructuring. The same analysis also identifies two different paths of state transformation associated with different strategies for increasing competitiveness. The fourth chapter focuses on explaining the reasons behind the choice of these strategies and elaborating on how political party systems shape the responses to the pressures arising from economic transnationalisation, as well as discussing the methodology and the basis for selecting the two case studies of different types of Competition States. The fifth and the sixth chapters trace the process of state transformation in the Czech Republic and Slovakia, demonstrating how the failures of their initial attempts at creating national capitalism and building Bismarckian-inspired welfare states led to the economic and currency crisis in the late 1990s – which prompted both states to turn from inwards-oriented to externally-oriented strategies of attracting FDI in order to boost their export competitiveness and restore economic growth. While the shift towards Competition State appeared in response to the crisis of national capitalism in both cases, the politics of these crises was however fundamentally different: with predominantly 'materialist politics' (Bohle and Greskovits, 2012: 82) giving rise to different and competing Competition State projects in the Czech Republic, and predominantly 'idealistic' politics centred on restoring liberal democracy giving rise to the complete hegemony of neoliberal externally-oriented strategy in Slovakia. The seventh chapter concludes the thesis by summarizing the main findings and discussing the implications of the study.

TRANSNATIONAL CAPITALISM AND THE RISE OF THE COMPETITION STATE

Introduction

What is the role of capitalist states in shaping the local socio-economic order in the context of increasingly transnationalized capitalism? How much space remains for differences among states' economic and social policies, and is this space carved solely by the variegated developments of transnational capitalism itself or is it also the result of purposive local political agency? Is there any scope for political agency to be exercised at the national level at all? The above questions obviously constitute some of the core 'big' questions of political economy and state theory in contemporary capitalism. Though it revisits these questions, the following chapter is far from offering definitive answers to any of them. The ambition here is much more humble: to shed some more light on the above questions, set out the main debates and positions in the literature, point to the dead-ends and some more promising avenues for research and try to offer a view on how to walk along the latter.

The chapter starts by offering a broad overview of the main debates on globalization and the state in contemporary political economy, contrasting the debates in comparative political economy focused on more or less state vs. more or less market, with the view advanced by the international political economy and the neo-Marxism-inspired *regulation* school in political economy which focuses on state transformation and the co-evolution of states and capitalism. Demonstrating that the latter may offer more interesting questions and clues for analysing state transformations in contemporary capitalism, the chapter will then proceed by elaborating on how this approach should be amended and how its combination with comparative political economy theories may provide new insights into the evolution of capitalist states. In a nutshell, the main argument is that the *regulation* school approach, and in particular its thesis that capitalist states are not disappearing but are rather experiencing the transformation from welfare state to Competition State, captures an important dynamic of contemporary political-economic changes. Nevertheless, while offering a useful starting point, the thesis of the emergence of Competition State still does not tell a complete story, since it fails to specify the exact mechanism through which globalization and post-Fordism exert pressures towards state transformation, and it also leaves open the question of whether there is only one type of Competition State or if there could be divergence among Competition States. Furthermore, the theory remains silent on the politics of state transformation and, although it states that the shift from one state form to another will come about through political struggles and conflicts among competing state projects, Competition State theory still fails to integrate the insights of political science and comparative political economy into its framework – and hence it fails to specify *how* domestic politics actually shapes the process of state transformation. The chapter thus concludes by offering an integrated framework for analysing the process of state transformation in Europe and proposing a methodology for undertaking such analysis.

Globalization and state debate

That globalization is leading states to converge on a single set of policies functionally necessary for survival in the context of a transnational economy has been a thesis both advanced and criticized many times in political economy. Two main approaches to convergence can be identified: one presenting convergence as the universal process of state shrinking and widespread liberalization, and another which sees convergence as a more complex but still equidirectional process of state transformation. The examples of the first can be found primarily in the management literature assuming the emergence of a 'borderless world' in which nation-states simply 'no longer make compelling sense as discrete meaningful units on an up-to-date map of economic activity' (Ohmae, 1995: 79). They also appear in political economy where globalization is supposed to undermine national autonomy in policy making through making Keynesian strategies non-viable; exerting a downward pressure on social protection systems; weakening the basis of tripartism by shifting the power from state and labour towards capital; and spelling the end of ideology by virtually excluding left-of-centre approaches (Mishra, 1999: 15). The first, and most common, assumption following from this diminished autonomy of policy making is that states are forced to engage in a simple 'race to the bottom' by cutting taxes and social spending and giving up on any attempts to interfere in the management of the domestic economy (Mishra, 1999). This conceptualization would thus expect a widespread process of 'state shrinking' as increased market liberalization and the race for mobile capital in the borderless world push governments to reduce their revenue intake as well as public expenditure. The expected direction of change is the one of convergence on the *laissez faire* or the minimalist night-watchman state reduced to establishing the rule of law, guaranteeing private property rights, free markets and free trade; in other words, the state simply oversees the proper functioning of the market, while the actual provision of services is left to the private sector. While that thesis has been fairly prominent, especially in media discourse and public debates, it has also been criticised and attacked quite often, in particular by comparative political economy literature. Given the bulk of evidence pointing to the lack of any such *laissez faire* convergence – evidence which will be reviewed in the next sections – the liberal convergence argument is neither the main target nor the starting null hypothesis of the present thesis.

Rather, the starting point here is the second line of convergence research, namely the thesis that globalization leads to convergence, or at least an equidirectional shift, across states through their adoption of similar policy reforms but that this process implies state transformation rather than state shrinkage. This is the principal line of reasoning found in the international political economy as well as the *regulation* school in political economy. '*The upheavals of the international political economy during the last decade have altered, irreversibly we believe, the relationships among states and multinational enterprises. Growing interdependence – that much abused word – now means that rivalry between states and the rivalry between firms for a secure place in the world economy has become much fiercer, far more intense. As a result, firms have become more involved with governments and governments have come to recognise their increased dependence on the scarce resources controlled by firms.*' (Stopford and Strange, 1991:1). This is the opening sentence of *Rival states, rival firms. Competition for world market shares*; one of the most influential books in international political economy which makes bold claims about the radically changed structure of global economy and its profound consequences on state power in the contemporary world. Yet, while the implication of this structural change has meant that states' policies must become more outward-looking if states are to find a place under the sun, the crucial part of international political economy argument is that '*an outward looking policy does not necessarily mean laissez-faire*' (Stopford and Strange, 1991: 12). Indeed, while states may have lost part of their space for independent action due to the effects of technological changes that enable cross-border production chains and economic interdependence, as well as the shift in the structure of international financial system away from nationally-centred credit systems towards a single system of integrated financial markets, the loss of capacity for policies that would be disliked by the international financial markets or by transnational corporations does not mean that the states are forced to restrain from any action whatsoever. '…*the growing competition among states-as-suitors means that government has shed some powers, but taken on others. Their role in fostering education and R&D assumes far greater proportion than hitherto in conditioning their success in attracting those foreign firms who might assist in achieving national aims.*' (Stopford and Strange, 1991: 56). While making strong statements about the decline of state authority or the narrowing of space for policy options, international political economy is thus far from arguing that diminishing state power will take the form of diminishing revenues or diminishing public spending. Instead, taking Stopford and Strange seriously means that we should be more focused in analysing the changes in what states do, the types of policies they develop, or how their priorities shift – rather than focusing simply on the 'more or less state' aspect.

A similar argument is made by Philip Cerny, who actually coined the term for the new form of state: Competition State (Cerny, 1990). Adopting Giddens' structuration theory and applying it to the relations between states and global economy, Cerny argues that global economic structures emerge as the result of state actions, but they in turn affect the state agency itself, leading to a shift from Industrial Welfare State to Competition State (Cerny, 1990). As he describes it, the essence of the Competition State is its active promotion of competition and globalization, neoliberal economic policy and, with regards to social policy, 'social neoliberalism', based on re-commodification and the insertion of people in the labour market (Cerny, 1990).

Perhaps the most elaborate account of these changes in the context of European states has been developed by the *regulation* school in political economy, which theorises the transformations of welfare states in the course of transition from Fordism to post-Fordism. The core of the *regulation* theory is its view of capitalism as developing in a non-continuous way which proceeds in a series of qualitative breaks (Koch, 2006). In this framework, the generous, redistributive and decommodifying welfare state is seen as part of the Fordist 'social compromise', when economic growth was based on mass production and mass consumption, and workers' wages were relevant not only as cost, but also as the source of demand. After the crisis of Fordism, apparent in the stagflation of the 1970s, and the emergence of post-Fordism based on intensive growth, economies of scope rather than scale and increased economic globalization, those Keynesian welfare states are expected to transform into Competition States, or Schumpeterian Workfare States not concerned with maximizing citizens' welfare through redistribution, but rather focused on actively promoting the competitiveness of their territory. The main theoretical contribution has been advanced by Bob Jessop, who lists the following main features of the ideal-typical Keynesian welfare state: demand management and an emphasis on full employment, the expansion of welfare rights with the aim of universalizing mass-consumption patterns amongst the entire population, and the primacy of national scale in economic and social policy. On the other hand, the ideal-typical description of the Schumpeterian Workfare Postnational Regime (SWPR) consists of state orientation towards increasing competitiveness and stimulating innovation and flexibility; workfarist social policy subordinated to competitiveness-enhancing economic policy; and an 'upwards', 'downwards' and 'sideways' shift in economic and social policy making, i.e. to supranational organizations, regional and local bodies, as well as non-state actors. With regards to social policy more specifically, the main distinctive features of the workfarist model thus include emphasising labour market flexibility, enhancing workers' employability and transforming them into 'enterprising subjects' suitable for the flexible, fast-changing economy (Jessop, 2002, Peck, 2001). These shifts in social policy are assumed to appear as part of the overall changes in states' economic policies from macro-economic to micro-economic and structural policies - and both of these are induced by the evolution of capitalism itself.

Not surprisingly, convergence theses have been widely criticised and a rich literature developed arguing that states continue to diverge in the policies they implement and in the way in which they respond to the pressures and challenges presented by global markets. Echoing Peter Katzenstein's thesis of small states in world markets, it has been argued that economic openness remains perfectly compatible with high taxes and high social spending since some of the most generous European welfare states have always been open for trade and have traditionally pursued export-oriented economic strategies while their corporatist institutions and generous social protection actually represented the means of compensation for this economic openness (Katzenstein, 1985; Garrett, 1998). Furthermore, despite the overall shift away from Keynesian demand management and towards supply-side policies, partisan politics was shown to still matter for the *type* of supply side strategies chosen – with Social Democrats opting for increasing the supply of capital through public investment and Conservatives opting for fostering private investment (Boix, 1998).

Comparative welfare state research has been particularly focused on rejecting the convergence thesis and successfully demonstrating that not all states are reducing their social and welfare provisions and converging on the liberal model. This is put down to the continued relevance of partisan politics and left incumbency for welfare generosity (Huber and Stephens, 2001; Swank, 2002); the path dependent support that previous welfare policies generated and which reform-minded elites found politically difficult to retrench (Pierson, 2001); or different welfare state institutions being assumed to be susceptible to different types of challenges in the open economy (Scharpf and Schmidt, 2000). More precisely, in the account of Scharpf and Schmidt (2000), the increased competition in international markets has had a profound negative impact on the level and quality of employment in internationally exposed sectors, particularly affecting low-skilled jobs, and this has further facilitated the shift towards employment in the sheltered sector of services produced and consumed at the domestic level. In that context, domestic shifts in employment opportunities associated with the increased internationalization of the economy set into play differential challenges and choices associated with the service-trillema in different welfare configuration. The service trilemma, as elaborated by Iversen and Wren (1998), emerges since productivity in services rises slower than in industry. A consequence of this is that states with service based economies face the trilemma of equality, employment and budgetary restraint and are only able to simultaneously pursue two of these goals so they inevitably run into budget deficits, unemployment or high inequality. According to their institutional configurations, different types of welfare states are thus liable to different challenges: unemployment in the Continental countries, large budget deficits in Scandinavian states, and large income inequality in the Liberal states. Furthermore, these different challenges should then also yield different responses, contributing to divergence rather than convergence.

Additional arguments in favour of persisting divergence also come from the political economists working within the Varieties of Capitalism (VoC) approach, as the two models of capitalism they identify – coordinated market economies (CME) and liberal market economies (LME) – are seen as complementary to different types of welfare state policy (Hall and Soskice, 2001; Estevez Abe et. al., 2001). While in LMEs firms tend to specialise in sectors based on general rather than firm- or industry-specific skills, firms in CMEs tend to specialise in incremental innovation which requires firm- and / or industry-specific skills. Viewing welfare state institutions such as social insurance schemes or employment protection legislation as the means to ensure that workers will be willing to invest in firm- or sector-specific skills, VoC literature argues that, contrary to the 'politics against markets' thesis, market actors will actually prefer to preserve the institutions that secure them comparative advantage (Estevez-Abe et. al., 2001). Consequently, increased competition in international markets will actually lead to increased divergence as it will foster further specialization among different varieties of capitalism.

Despite the empirical richness and theoretical sophistication of the VoC and comparative welfare state regimes arguments, there are still some major deficiencies with the way comparative political economists approach the problem, especially when it comes to their empirical analysis. In particular, the main target of the comparative empirical studies, and the main hypothesis they seek to reject, is the hypothesis of 'state shrinkage' – conceived of as the convergence to the 'liberal welfare state regime' or liberal market economy and operationalized as a decrease in taxation and social spending. Yet, the expectations of convergence on the *laissez-faire* approach, or the hypothesis of 'state shrinkage', represent a rather problematic starting point since the arguments that globalization will lead to state shrinkage appear theoretically weak. As Huber and Stephens (2005: 558) argue, there are two main lines of reasoning that give rise to expectations that globalization should lead to welfare state retrenchment. One, which they label the 'neoliberal thesis', is based on the assumption that state intervention and deviation from market principles are inefficient; hence, in the context of economic openness and increased competition, these types of 'liabilities' have become more apparent as they raise the cost of production. In essence, this is the argument that globalization leads to convergence on the most efficient model – with the minimalist and liberal state considered to be more efficient than an 'interventionist' one, as markets are considered to be more efficient than states. The other argument, which they label 'social democratic', is more in tune with power-resource perspective as it suggests that the opening of international capital markets greatly increased the power of capital to do 'regime shopping' and thus press national governments to retreat from interventionist policies and generous and egalitarian welfare state policies (Huber and Stephens, 2005: 558). This type of argument is thus based on the assumption that capital prefers a minimalist state. However, as the social democratic scholarship (including Huber and Stephens themselves) is at pains to demonstrate, not *all* state interventions are considered business-unfriendly and some of them may even increase efficiency. '*Spending on health and education, active labour market policy, and policies that enable combining work and family, such as parental leave and day care improve human capital and increase labour supply*' (Huber and Stephens, 2005: 566). A similar acknowledgment of the continued or even increased importance of the state provision of skills or R&D has already been noted in international political economy scholarship (Strange and Stopford, 1991). If this is indeed true, the increased bargaining power of capital should not lead to the complete withdrawal of the state from *any* intervention – rather it should lead to a reorientation from more labour-friendly to more capital-friendly measures and policies. Put differently, to the extent that globalization with increased competition and increased capital mobility indeed exert structural pressure on states, these pressures should be manifested in the form of state transformation towards a Competition State, rather than transformation towards a minimalist night-watchman state.

In addition to the 'neoliberal' and 'social democratic' theses, a third type of argument on convergence is based less on the notion of globalization as imposing structural pressures upon states, and more on globalization as an intensified transfer of ideas – where it is again the predominance of neoliberal theories that drives the implementation of policy reforms in different countries. However, this thesis is once more based on the problematic assumption that the spread of neoliberal ideas and, more broadly, the doctrine of neoliberalism imply a process of state withdrawal and a reduction of its activities to the minimalist nigh-watchman state. The latter is, however, the preferred model of *classical* liberal doctrine, but not of the *neo*liberal one. Indeed, while classical liberalism has been concerned primarily with freedom from the state, advocating the 'minimalist night-watchman state', neoliberalism instead seeks to redefine the state as an important actor whose main role becomes that of establishing and preserving competition as the core principle of the neoliberal understanding of the market (Foucault, 2008;

Mirowski et. al., 2009). Hence, according to the 'ethics of neoliberalism', some policies are indeed understood as part of the problem (primarily those aiming at redistribution), while others, such as education or active labour market policies are perfectly legitimate since they aim at recommodification and helping individuals to compete on the labour market (Amable, 2011). The philosophical origins of neoliberalism are thus far from aiming at reducing the role of the state; rather, neoliberalism as a political project itself aims at state transformation into an agent managing and adapting citizens to the needs of the market. This is true not only for the philosophical basis, but also for the policy prescriptions commonly associated with neoliberalism, such as the famous Washington Consensus that, as John Williamson put it, represent the common platform of policy reforms that 'Washington' – i.e. the international financial institutions, the US Congress and the economic agencies of the US government – advise and preach to developing countries (Williamson, 1989). The consensus indeed contains numerous points that are commonly associated with the idea of the primacy of markets over state action – such as deregulation, privatization, enforcing property rights, tax reform and so on. However, with regards to public expenditure, the idea seems not to be one of a complete retreat by the state, but rather of appropriate public expenditure *priorities* – cutting subsidies that cover the losses of state enterprises, but maintaining expenditure on public infrastructure as well as spending on education and health, which, because of their character as investment in human capital 'are regarded as quintessentially proper objects of government expenditure' (Williamson, 1989). This actually puts the allegedly 'neoliberal' Washington consensus pretty close to the social democratic consensus on the benefits of 'proper government expenditure' – and it also makes the efforts to refute the thesis of the shift to 'neoliberal state' by looking at state expenditure on health and education, as many studies do, a rather futile enterprise. On the other hand, the OECD has certainly been the prime promoter of labour market flexibility – but this is again coupled with the concerns on 'enhancing human capital'. Thus, if there is any consensus at the level of supranational organizations and policy communities, it is most certainly one that still accepts some government expenditure as 'proper'.

What all of the above suggests is that, upon close inspection, the rationale for expecting some kind of 'neoliberal convergence', with 'neoliberal' conceived simply as the minimalist state ensuring only property rights and letting the markets do all the rest, appears rather shallow. Conceptually, it is wrong to assume that 'neoliberal state' should be identified with minimalist state and operationalized as the state with low taxes and low spending – both because of the philosophical origins of neoliberalism and because of the way in which neoliberal ideas have been transformed into concrete policy recipes advocated by international organizations. Theoretically, to the extent that the state disappearance or neoliberalization is supposed to come about as the response to economic changes and the emergence of increasingly transnationally-integrated economies, none of the multiple facets of globalization imply convergence to the minimalist state. As some state policies are indeed seen as beneficial for nurturing export-oriented industries or for attracting investments, neither the 'efficiency' nor the 'mobile capital' type of argument appear consistent with an expectation of a complete retreat of the state from the provision of any type of public goods.

Consequently, if one wants to criticise or disprove the thesis that globalization is leading to convergence among state policies, the more plausible target should be the thesis of the rise of the Competition State rather than the thesis of the convergence to the *liberal* model. Moreover, if one wants to show that, contrary to international political economy claims, national politics still matters, one would be better to start by taking a null hypothesis that will actually reflect the theoretical expectations of international political economists. The present thesis seeks to undertake precisely that task and empirically assess the extent to which globalization has indeed led to the rise of the Competition State and whether this transformation represents a convergence on one single set of policies or, alternatively, if different strategies for increasing competitiveness and attracting capital can be identified.

The politics of competitiveness

Although Cerny and Jessop are usually seen as the most relevant theorists of Competition State – with Jessop using the concept of Schumpeterian Competition state and Schumpeterian Postnational Workfare Regime interchangeably (Jessop, 2002) – the most succinct definition in the literature is probably the one offered by Boyer, who defines it as the state seeking to promote 'enterprise, foreign investment and innovation' (Boyer, 2000a: 14). Regardless of the slight differences in terminology, the Schumpeterian Workfare State described by Jessop (2002) and Competition State described by Boyer (2000) or Cerny (1990) actually share many of the same features. In both accounts, either due to the structural pressures stemming from the economic transformations, post-Fordism and the emergence of the transnational market, or due to the political interpretation of the 'needs' to adjust to the global economy, the state is supposed to undergo the same process of transformation. Contrary to the misinterpretations of globalization-as-state-shrinkage, the argument here is not that the state will 'shrink', but rather that it will reorient its activities towards 'increasing structural competitiveness'. The question of the implications of globalization for welfare and social policies hence becomes not whether we see *more or less* state intervention, but rather *what kind* of intervention we see. This argument seems to me like a more promising avenue of research than the thesis of 'liberal convergence' for two theoretical reasons. First, it stresses the importance of the fact that competition for capital does not automatically imply a *laissez-faire* approach since some state policies are beneficial for fostering investments. Second, it shifts the attention from the question of *more or less* state intervention in the market to the question of *how* states and markets are shaped by each other. It is thus more consistent with the economic sociology perspective where states and markets are not considered as self-contained entities battling for a share of a finite economic space, but rather as co-constituting each other (O'Riain, 2000; Block and Evans, 2005). From this perspective, the expectations of convergence on a liberal state which supposedly abstains from intervening in the market appear problematic as states and markets are not analytically autonomous realms, but mutually constituting fields of activity. Even the prototype of a liberal state – the USA – is far from being an 'absent' night-watchman state. Not only has this been challenged by the interventions in the latest financial crisis, Block (2008: 169) also demonstrates how the US industrial policies can actually be better described as the actions of a 'hidden developmental state' while Howard (2007) points to the often ignored side of the hidden US welfare state institutionalized primarily through various forms of tax deductions. The state is thus always an important element in shaping the market and the only question is *how* it does so.

Nevertheless, although the thesis of the transformation from welfare to Competition State has many advantages over the already worn-out debate around state shrinkage vs. business-as-usual, the problem with Competition State theory is that it remains surprisingly silent on the *politics* of state transformation. In particular, although it is argued that the change of state form appears through political struggles among competing 'state projects', the outcome of which will also depend on 'institutional legacies, the balance of political forces and the changing economic and political conjunctures in which different strategies are pursued' (Jessop, 2002: 267), it is not clear whether the outcome of these political struggles may lead only to variation *among* Competition states or if it can also lead to the *absence* of any change, nor is it clear how the implied variation would look. Theoretical accounts of the regulation school scholars have not even tried to integrate its theoretical framework with the insights of comparative political economy or political science – the only such attempt has been the proposed variation in the paths and institutional forms of state transformation leading to neo-statist, neo-corporatist and neo-liberal road to Competition States (Jessop, 2002), but this has again been the proposed typology of the road to be travelled, while the destination should be the same for all. This is especially surprising since institutional legacies are considered important in the process of state transformation and the authors here actually refer to Esping-Andersen's welfare states models (Jessop, 2002; Peck, 2001) as the relevant institutions that should matter for state transformation. Nevertheless, they still do not specify *how* exactly these institutions would matter. It is clear, for instance, that some features of the Competition State were apparent already in different types of welfare states: activation and flexibility were important parts of Social Democratic welfare states where they were supposed to ease the workers' transition to more productive sectors in the framework of the Rehn-Meidner model (Steinmo, 2010). In this model, however, they were coupled with a very generous unemployment compensation system, which would certainly not be part of Competition State. On the other hand, low out-of-work income protection and liberal labour laws have always been the features of liberal welfare states, though without a focus on activation. Rather than single policies, it is thus patterned *combinations* of policies that characterize Competition State and distinguish it from different types of welfare states and one might indeed expect that the pre-existence of certain elements in these combinations would actually facilitate the process of transformation since existing institutions may be used as building blocks for the establishment of new institutional ensembles. Existing institutions thus could play a role in state transformations not only by acting as barriers to change, as the 'new politics of welfare state' literature suggests, but also as facilitating the process of change.

While the role of institutions could probably be best explored in empirical studies relying on Competition State theory, this has still not happened since most Competition State literature has been purely theoretical and any empirical studies that have been undertaken typically adopted the methodological strategy of taking one single case study and demonstrating the applicability of the theory to that particular case (Torfing, 1999; Drahokoupil, 2009; Soederberg, 2010). This, however, does not shed much light on the politics of state transformation since the above case studies functioned only as illustrations of the theory, rather than assessing to what extent the theory is applicable to different cases or attempting to explain any divergences found.

A notable exception to this methodological strategy is the medium-N study of Barbara Vis (2007) which looks at the shift from welfarist to workfarist social policies in Europe. However, she only examines one dimension of the changing state form – i.e. social policy – thus testing only part of the story. Productivist social policy is seen as but one aspect, and a subordinate one at that, of the shift to Competition State while the more important feature is the shift of economic policy away from macroeconomic concerns and towards supply-side oriented 'structural' economic policy – as Torfing puts it, "the core argument is that the different mixes in the fields of economic and social policy are not disconnected" (Torfing, 1999:9). The idea of the Competition State thus presumes what Shin (2000) calls policy linkages, i.e. the turning of both economic and social policy in a more business-friendly direction. Hence, none of the previous studies (with the exception of individual case-studies) actually tried to see whether there were linkages between economic and social policy, nor did they look into whether some countries have indeed converged on the Competition State model. Furthermore, there has not yet been any empirical exploration of the possibility of varieties of Competition States, nor has there been an inquiry into what combinations of competitiveness-enhancing policies are actually found in different states.

A related problem with Competition State thesis lies in the fact that the main concept of the theory and the main goal towards which all state policies are being reoriented – namely, 'competitiveness' – remains largely unspecified. Economists tend to understand competitiveness primarily as a level of success in capturing larger shares of markets in global trade – indeed this was the sense used in Paul Krugman's seminal article on the 'dangerous obsession' with competitiveness (Krugman, 1994: 28). Fougner (2006), on the other hand, traces the history of the concept of competitiveness and argues that over time it has shifted from understanding competitiveness as 'aggressiveness' to seeing it primarily in terms of 'attractiveness' as competitive states are assumed to be those that present a desirable location for investments. However, aggressiveness and attractiveness are actually closely intertwined in the idea of Competition State since the main assumption is precisely that the states are supposed to ensure the successful insertion of their economies in transnational markets through attracting private investment – rather than for instance through relying on public investments (which would correspond to the social democratic strategy in Boix, 1998) and rather than by imposing tariffs or other barriers that would shelter the domestic economy from the pressures of the transnational markets. As succinctly put by Susan Strange: '*Governments, for their part, have become acutely aware that they are competing, as rival suitors, for the favors of foreign firms. These firms often have attractive assets that native ones lack. They may have command of better technology and therefore are more likely to gain and keep market shares and also to give employment to local citizens. They may have better access to capital, and they may have established distribution systems giving them instant access to foreign customers and therefore to foreign exchange if they will set up a local production plant.*' (Strange, 1995: 60).

In principle, however, there are different ways in which states may strive to increase their attractiveness to foreign firms. One approach sees the existence of relatively cheap conditions for doing business as the main point of attractiveness and thus emphasises low taxes, low social contributions, a cheap labour force, or low administrative barriers. This approach would actually have its basis in the neoclassical theories of economic growth according to which capital is supposed to flow where there are higher rates of return, linked primarily with lower operating costs (Solow, 1956). Another strategy would be more grounded in the New Growth or endogenous growth theory (Romer, 1986), according to which endogenous factors – such as human capital levels or research and development – provide increasing returns to capital, the implication of which would be that the ambit of a business friendly government includes not only reducing the cost of doing business but also policies that produce growth-enhancing collective goods undersupplied by the market. Typical examples of such goods are public education and training, high quality physical infrastructure while one may also add the quality and abundance of local suppliers as yet another factor increasing the attractiveness of a country as a location for investments. A related dilemma revolves around the extent to which the state should influence the *kind* of investment it is striving to attract: should it try to actively lure the type of investment associated with high-value-added parts of production chains or should it instead adopt a *laissez-faire* approach and leave to the investors to decide which type of activities they will invest their capital in? The policies and strategies mentioned by Competition State theorists indeed assume a combination of approaches that would encompass both more *laissez-faire* policies, such as lowering taxes and social protection, as well as more activist tactics, such as fostering R&D, investing in education or handing out tailor-made investment incentives. However, whether all of these policies indeed appear as part of the distinct 'state projects' implemented by individual states remains a question that still has to be answered by the empirical research.

To a certain extent, the above dilemmas about what constitutes a desirable environment for attracting capital and the associated strategies states may use in their competition for capital appear analogous with the different forms and strategies of competition in product markets, where economists typically distinguish between price competitiveness and quality competitiveness. In this context, however, price and quality competitiveness would refer not to the products of firms, but to the dimensions of states' attractiveness. Price competitiveness in the context of competition between states would involve the states' emphasising the low costs associated with doing business in their territories – in other words, low taxes, low social contributions, cheap labour force, low administrative barriers and so on. On the other hand, quality competitiveness would imply competition on the basis of quality – be it the quality of the local skilled workforce, quality of infrastructure, abundance of local suppliers, etc. While the first type of competitiveness strategy would be concerned primarily with attracting capital through lowering the burdens on business and providing a low-tax and low-wage environment, the second type would compete for capital on the basis of its specific qualities such as the skills of the workforce, the presence of good local suppliers or the local R&D facilities.

While there could thus be different strategies for increasing a state's attractiveness as a location for investment, as well as different approaches to state activism when it comes to the type of private investment fostered, the question which of these approaches or strategies – understood as combinations of policies for increasing competitiveness - will be adopted is far from trivial. Competition State theory, as already noted, does not really give an answer to this question since it assumes that all of these policies are indeed supposed to be apparent in all states participating in the race for capital. On the other hand, according to the world's most influential benchmarking agency measuring competitiveness of nations, the Global Competitiveness Index, the best strategy for increasing competitiveness crucially depends on the stage of development of national economy, i.e. whether its competitiveness is factor-driven, investment-driven or innovation-driven. '*For some low-income economies the main challenge is to get the basic factor markets – for land, labour and capital – working properly. As countries advance, the basic challenge is to make connections with international production systems by attracting sufficient flows of FDI. Once reaching high-income status, the basic challenge facing countries is typically to generate high rates of innovation and commercialization of new technologies. The critical institutions in a country, and its barriers to continued growth, will therefore differ depending on that country's current position.'* (Porter et. al., 2001: 17). For political economists in line with Katzenstein, the crucial variable is state size (Katzenstein, 1986); while in the Varieties of Capitalism school competitive advantage depends on the overall institutional framework of a given political economy, with coordinated market economies differing from liberal market economies. Not much space is thus left for domestic politics or the agency of domestic political actors to actively shape the strategies for increasing competitiveness. On the other hand, the studies of partisan strategies in open economies, already mentioned above, tended to focus on partisan differences in providing social compensation for economic openness (Garrett, 1998), rather than different forms of managing economic openness, or alternatively focus on the differences in the provision of private vs. public investment (Boix, 1998) rather than differences in the state strategy for fostering private investment.

Nevertheless, since structural pressures generated by state competition for capital must still be *interpreted* as pressures, and the specific policy responses to these pressures still have to emerge as parts of distinct political agendas, the argument here is that the adoption of specific strategies for attracting investment and increasing competitiveness will be likely to depend on *political* factors at the national level. Furthermore, and similar to the arguments on 'beneficial constraints' fostering the emergence of quality-based competition among economic actors (Streeck, 1997: 197), I would argue that it is the existence of political constraints that leads to the emergence of political programs for quality-based competition among states. Policy makers are thus conceived as ideational entrepreneurs - and it is the constraints of the political field that lead them to innovate and come up with policy strategies based on quality rather than cost competitiveness. To push the analogy even further, similar to Streeck's examples of firms that, in the presence of high minimum wages, employment protection or strong trade unions, have to come up with the so called 'high road' strategies that will make their products successful on the market *despite* higher labour costs, so states faced with similar constraints must develop strategies that will make them attractive for capital, while at the same time ensuring that they do not engage in 'social dumping' and that their respective strategy still enables higher wages for their citizens. In both of these cases, therefore, we may assume that the primary constraints pushing towards a quality-based strategy of competition would stem from the political power-resources of labour. Following Walter Korpi's classical elaboration, the strength of the labour power-resources has typically been identified with the strength of the left parties, as well as the levels of unionization and the type of union organizations (Korpi, 1983). Nevertheless, an important precondition for the strength of labour power in the political arena is that the latter is actually based on a struggle over distributive issues – in other words that socio-economic cleavage is indeed the most important basis for the structure of the party system. To the extent that the latter is the case, and that 'democratic class struggle' indeed is prevalent in a given political system, state transformation would be more likely to follow a 'high road' rather than a cost-cutting 'low road' strategy. As the literature on competitiveness has already noted, there are different ideas and views on competitiveness of states (Fougner, 2006; Van Appeldoorn, 2002). My argument is, however, that it is ultimately the constraints of the national political system – and primarily the features of the national political party system – that determines which of these ideas come to be translated in the national political arena and which of them are developed into the specific policy proposals and reforms that countries implement. This is exactly the point where political science and comparative political economy may provide a useful amendment to the Competition State theory.

Four propositions are advanced here in order to amend the deficiencies of the current state of the art in the globalization and state debate.

1. Economic transnationalisation does not create structural pressures for states to converge on the *laissez-faire* liberal model; rather it creates pressures for states to turn into Competition States
2. Transformation from welfare to Competition States should not imply convergence. By analogy with the forms of competition in product markets, two main types of strategies for increasing competitiveness can be distinguished: a low-road based on price competitiveness and associated with cutting taxes and lowering labour costs; and a high-road based on quality competitiveness and associated with providing investment subsidies and increasing human capital spending.
3. The end result of the transformation will depend both on the initial institutional setup – i.e. the starting point of state transformation – and the specific strategy of increasing competitiveness chosen by national policy makers.
4. The choice of strategies for increasing competitiveness will depend on the existence of national level political constraints and, in particular, the constraint of a political party system based on socio-economic issue divides. National level institutions and politics thus matter for the *direction* of state transformation; however, national politics do not override the structural pressures generated by transnational economy.

Competition State and European integration

The thesis focuses on Europe since it has traditionally been the site of the most generous capitalist welfare states, whose transformation the theory of Competition state seeks to describe, and it has also been home to different types of welfare states. Furthermore, the structural pressures of economic transnationalisation are supposed to have been further exacerbated by the process of European integration as the latter has brought together political economies with quite different varieties of capitalism and welfare states, thereby intensifying the 'battle of the systems'. Through the creation of the Single Market, the main purpose of the European integration has indeed been to foster the mobility of people, goods, services and capital, thus intensifying both the pressure on firms to become competitive in the common market, as well as the pressure on states to become competitive in the race for investment. Especially with the accession of the UK and Ireland, the content or social purpose of the European project was seen as turning from its initial 'Monnet moment' of consolidating regulated capitalism on a wider scale to the pursuit of neoliberalism, while the launching of the Lisbon Agenda in particular represents the Schumpeterian-workfarist shift at the EU level (Jessop, 2012: 102). Therefore, European states are experiencing even stronger pressures to reorient themselves towards increasing competitiveness since both globalization and their particular mode of regional integration are pushing in the same direction. In the words of Wolfgang Streeck: '*Decentralization and competitiveness hang together since the fragmented institutional base of European solidarity remains exposed to competitive pressures, not just from the outside world, but also from inside Europe itself (…)In trying to adapt to the new economic circumstances, national communities seek to defend their solidarity, less through protection and redistribution than through* ***joint competitive and productive success*** *- through politics, not* ***against*** *markets, but* ***within*** *and* ***with*** *them, gradually replacing* ***protective*** *and* ***redistributive*** *with* ***competitive*** *and* ***productive*** *solidarity'* (Streeck, 1999: 7, emphasis in original).

According to the prevailing view, the need for this competitive state reorientation has become particularly strong since the establishment of the monetary union, which took monetary and exchange rate policies off the menu of policy-making options and concomitantly left the states with the ability to make only fiscal and labour market adjustments in case of economic shocks (Crouch, 2000). There has, though, been some debate in the literature with regards to the precise mechanisms through which the EMU is supposed to be detrimental for European welfare states. Some authors argue that monetary policy has already been circumscribed by volatile international capital markets so that the primary negative effect of the EMU should come about through tough policies of the European Central Bank and the resulting levels of unemployment which would be too high to sustain the European social model (Martin, 2004). Rather than the primary cause of the challenges to the European welfare states, the EMU is thus seen as a supranational response to the structural pressures already emerging from both economic transnationalisation and the rise of international financial markets. Nevertheless, while, in theory at least, this response opens the door for a more welfarist or Keynesian kind of public intervention at the supranational level, it still intensifies the pressure to adopt competitiveness-conforming policies at the *national* level (Boyer, 2000b). Even for those who see the EMU as being 'good' for the welfare state, its beneficial effects are deemed to be associated not only with enhancing the credit-worthiness of states, thereby making it easier to finance social expenditure, but also with the political opportunity opened by the requirements of the Maastricht criteria to introduce the necessary reforms and modernize and restructure the welfare state (Rhodes, 2002). The EMU was thus supposed to bring about not only a 'stability culture' but also a focus on 'competitiveness' as the new discursive focal point, facilitating regulatory reforms as well as the reform of welfare state and industrial policy (Radaelli, 2002: 234). Furthermore, it was also expected to foster tax competition and competitiveness enhancing reforms, especially in small countries where domestic demand appears less relevant for their economic growth (La Cacheux, 2007). Given the consequences for the welfare states as well as for European labour, the EMU has thus been dubbed the 'neoliberal Trojan horse' for Europe (Lucarelli, 2004: 81).

Another 'neo-liberal Trojan horse' challenging the European social model has arrived in the form of the Eastern enlargement and the accession of 10 post-socialist member states (Malova, 2003). The enlargement has indeed triggered fears of a competitive 'race to the bottom' due to both capital scarcity and the presence of a cheaper labour force in the East, as well as due to the radical neoliberal policy experiments undertaken by some of the new member states since the fall of socialism. The debate on Eastern European social models and their implications for Western member states has produced very different positions, with some authors arguing that Eastern European members are developing into European-style social market economies (Katzenstein, 2003) and Bismarckian welfare states (Cerami, 2006; Inglot, 2009), while others take the position that the East has indeed engaged in competitive race to the bottom by cutting taxes and social expenditures and emulating the liberal model in order to attract foreign investment (Appel, 2011; Nolke and Vliegenthart, 2009). Probably the most interesting contributions have been made by those authors that argue that there is actually a *variety* of social models and variety of capitalisms in the Eastern periphery of Europe. In this vein, Bohle and Greskovits (2012) distinguish between neoliberal capitalism in the Baltic countries and Southeast Europe, embedded neoliberal in the Visegrad region and neocorporatist capitalism in Slovenia. Similarly, Bruszt and Greskovits (2009) classify Eastern European political economies according to their profile of global insertion and their patterns of social cohesion into semi-core and semi-peripheral ones, the former being characterized by predominantly complex exports and higher levels of social cohesion, and the latter by less sophisticated export structures coupled with higher social inequality and lower levels of social protection. While these studies examine both state policies and economic structures associated with patterns of transnationalisation, the work of Drahokoupil (2009), on the other hand, focuses exclusively on the evolution of states and their policies for FDI attraction in the East. It argues that, while the Baltic states do correspond to the purely neoliberal model, the four Visegrad states have instead converged on the model of Porterian Competition States focused on industrial upgrading through attracting manufacturing FDI, while simultaneously reorienting their social policies towards the goal of increasing competitiveness.

The debates on the Eastern and Western parts of Europe have however proceeded largely on separate tracks. Mainstream political economists have tended to focus on the West and largely ignore the new capitalist democracies of the European East, leaving regional specialists to develop theories and tools for analysing the postsocialist transformation or, more recently, transnationalisation of Eastern political economies, with both groups assuming – rather than empirically assessing – the persistence of profound differences between the two sides of the old Iron Curtain divide. Although such a position might have been justified during the Cold War or in its immediate aftermath, it is much less clear that the existence of such differences can be simply taken for granted 20 years after socialism disappeared from the European territory. All of the current EU members represent highly industrialized societies that have been undergoing a process of industrial restructuring, or deindustrialization coupled with a shift to a service economy; they are all certainly capitalist economies; and all are democracies. Hence, comparing the two European halves can hardly be presented as the case of comparing the incomparable – and while important differences might indeed exist in the institutions of their welfare states, or in the specific policies they implement, these differences should be a matter of empirical question, and not simply taken for granted and attributed to some essentialized feature of 'postsocialism'. It is true that some of the Eastern EU member states have indeed been the site of rather extreme liberal experiments, with flat-tax regimes and radical pension reforms not seen anywhere in the West; yet to what extent these have resulted in state forms profoundly different from those in the West can be seen only in a comparative analysis using the same indicators for both the East and West, thereby allowing the exact distance between the two to be grasped.

The present thesis thus starts from an analysis of European Union as a whole - and it does so using a statistical analysis that does not *a priori* label states as Eastern or Western, hence empirically testing the extent to which the two are indeed different species. Furthermore, while the Competition State theory was developed for Western European capitalist welfare states, there is actually a number of reasons why, given the historical context of their emergence in the global capitalist market, the states of the Eastern Europe would be even more likely to develop in such a direction. First, if, as Busemeyer (2009: 461) argues, it is not the level of economic openness, but rather the *change* in economic openness that matters for the relation between globalization and welfare, then Eastern Europe represents a radical case of almost completely closed and inward oriented economies (though there were variations in this respect) turning into profoundly transnationalised ones, with predominantly export-led growth and a high share of foreign owned enterprises in their economic landscape. Second, since the transition from welfare to Competition State primarily means the erosion of the concept of social citizenship, this is certainly more likely to appear in countries where the principle of social citizenship was never firmly established. While Eastern bloc states certainly provided welfare during socialism, their social policy was nevertheless fundamentally productivist in nature and based on participation in the economic system, rather than on the protection of income regardless of participation (Offe, 1996). Third, to the extent that the rise of the Competition State is the result of the spread of ideas and policy advocacy of various international and transnational organizations (the OECD with its mantra of labour market flexibility; the EU with its emphasis on entrepreneurship and a knowledge-based economy on the one hand, as well as activation, employability and human capital on the other hand; the World Bank with its promotion of a business-friendly environment; or various organizations such as the World Economic Forum, measuring and at the same time constructing the notion of 'competitiveness'), Eastern Europe has also seen transnational policy networks being very active, not least due to the fact that policy advice comes attached to financial packages, such as the World Bank loans or the EU structural and pre-accession funds. Nevertheless, while the Competition State indeed is more likely to appear in the East rather than in the West, only empirical analysis can show whether such a development has indeed taken place, and whether it is something peculiar to post-socialism or actually affects older and newer capitalist democracies in Europe to the same extent.

Earlier empirical studies of state transformations in Europe – usually undertaken in respect of specific policies – suggest that reforms tending towards the creation of a Competition State are indeed apparent across Europe. In terms of fiscal policies, there has been a widespread trend of cuts in corporate tax rates and shifting from direct to indirect taxation (Devereux et. al, 2008). The situation is similar with respect to state subsidies given for investment. In the context of European integration, the creation of the single market has meant that trans-European investments have become easier than ever – and accordingly European states are now in a position similar to the states in USA with regards to competition for investments. In his book *Competing for Capital*, Kenneth Thomas (2000) indeed compares the locational competition in the EU with that of the US and argues that the EU is – through its provisions on state aid - actually more efficient than the US federal government in combating investment incentives bidding wars among states. However, Thomas also reports that, despite the official figures showing a decrease in state aid, interviews with development officials and site consultants suggested that locational competition has become fiercer in the EU and that the generosity of grants has increased (Thomas, 2000). Furthermore, I would suggest that the role of the EU in regulating state aid is actually a bit more complex than Thomas' analysis shows and it is not so unambiguously geared towards reducing locational competition. First, with respect to the state aid regulation, the EU has recently simplified the procedures for awarding state aid under the so called 'General Block Exempted Regulations' (GBER) which encompass a rather broad scope of goals for which aid is perfectly legitimate – such as 'regional development', 'employment', 'innovation', etc. The EU has indeed been more active than the US in regulating state aid – but this regulation seems to be less about reducing state aid, and more about re-orienting it away from those specific sectors that were traditionally supported – and often owned – by the state (such as steel, shipbuilding, or railways) towards schemes that precisely fit the description of subsidies for mobile investment. By allowing the aid for 'employment' in case of new investments, while at the same time banning aid to 'sunset' sectors that *used to* employ a large share of the traditional blue-collar working class, the EU has simply redefined what constitutes legitimate state aid and the type of 'employment' for which this aid may legitimately be granted. Most likely, the biggest beneficiaries of the reforms of EU state aid regulation have in the end been precisely the most transnationalized sectors and companies, at the expense of the more local or national ones.

In addition to its efforts in reorienting rather than abolishing aid granted from the state budget, the EU has played another important role in locational competition – that of providing the funds itself. Indeed, the regional development funds and the cohesion fund have often been used precisely for financing investment subsidies – and this practice has actually intensified over time. While in 1987 and 1988 support for infrastructural projects accounted for 80% of Structural Funds, the reform of the Funds and its subsequent doubling in the 1989-93 round was also accompanied by a re-orientation towards aiding investments so that 80% in Objective II measures (as opposed to only 16% earlier) was designated to 'support investment in industry and services, to improve the business environment and to develop human resources' (Thomas, 2000: 98). In those Eastern European countries joining the EU, the first Investment Promotion Agencies were actually financed from the EU PHARE program (Drahokoupil, 2009: 116). Hence, while the regulation of state aid and the EU Competition Policy may be seen as the institutions limiting, but also reorienting the use of state subsidies, the Regional Policy of the EU actually provided the fuel for fostering competition through subsidies.

The joint effect of EU policies with respect to locational competition is difficult to assess. Nevertheless, an important point is that European economic integration has created a situation in which national governments are increasingly under pressure to compete for investments through the use of investment subsidies, while the relevant EU policies appear, at best, ambiguous with respect to reducing such competition. Taken together, this means that the pressures for reorienting state spending from labour friendly to capital friendly measures have grown stronger in the course of the European integration, particularly with the Eastern enlargement and the appearance of former socialist economies as potential investment sites.

Studies of social policy reforms also show substantive transformations of European welfare states. While the earlier research has argued that stability, rather than retrenchment, is the dominant feature of European welfare states (Huber and Stephens, 2001; Pierson, 2001; Swank, 2002), more recently the attention has turned towards the transformation of social policies. This has been seen primarily in the field of labour market policies, where there is increased emphasis on flexibility, activation and the shift from entitlements to obligations (Clegg, 2008; Papadopoulos, 2005, Hauserman and Palier, 2008), but also in pension systems where privatization and risk individualization has been a predominant trend since the 1990s (Ellison, 2006; Kohli and Arza, 2010). The overall shift has thus been described as one of recommodification rather than decommodification and the shift towards human capital oriented measures – what part of the literature has labelled as the 'social investment state' (Giddens, 1998).

Hence, recommodification, activation and more business-friendly economic policies roughly corresponding to the description of the Competition State seem to be widespread across a variety of European political economies. However, the questions of whether these policies have indeed been combined in the way in which Competition State theory assumes, leading to the emergence of a new state form, and whether or not they have produced convergence or divergence still remain open for empirical research. The present thesis aims to undertake precisely this research by first operationalizing the concept of Competition State – something that the literature up to now has failed to do – and, secondly, using it in an exploratory statistical analysis aimed at identifying whether such a form of state has indeed appeared in Europe between mid-1990s and the advent of the latest Great Recession. In order to do this, the next chapter will first elaborate on the relevant dimensions of the Competition state, offering an operationalization of the concept, before then using cluster analysis in order to see whether the combinations of policies expected by the theory empirically appear in specific countries, and whether they lead to one or several types of Competition States. After identifying the main patterns of convergence or divergence in Europe, the following chapters will focus on examining the politics of state transformation through selected case studies.

MAPPING THE TRANSFORMATIONS OF THE EUROPEAN STATES

In order to see whether there is such a thing as the Competition State in Europe and which states have been transformed into this model, the first step of the research is to develop an operationalization of the concept of the Competition State and use it to analyse similarities and differences across European countries. The methodology chosen is cluster analysis – an exploratory research technique used to identify groups in the observations. The main aim is to empirically examine whether Europe has seen the emergence of countries or groups of countries that display the particular combinations of policies assumed by Competition State theorists, as well as whether these type of transformations have led to convergence or divergence across Europe. The first part of the chapter provides an operationalization of the concept of the Competition State, while the second part gives a more detailed account of the statistical method used and presents the results of the analysis.

Operationalization of Competition States

By arguing that Competition State seeks to promote enterprise, innovation and foreign investment as well as labour recommodification, the definitions and descriptions applied to the Competition State actually rely more on discussing the goals of the state, rather than particular state actions. For the purpose of empirical analysis we thus need to first disentangle specific dimensions of state policies that are relevant for achieving these goals. More precisely, the concept of the Schumpeterian Workfare Postnational Regime entails four different dimensions that concern: types of economic policies, types of social policies, primary scale of policy making and primary mode of governance (state or market). Since the main focus is, however, on the analysis of states and since Competition State theorists themselves claim that there are differences in the mode of economic governance and the level of 'statism' in policy making among Competition States (Jessop, 2002: 262; Torfing, 1999: 374), the latter two dimensions actually amount to variations of Competition States rather than differences in whether a state is a Keynesian welfare state or a Schumpeterian Competition State. Hence, for the purposes of an empirical analysis of state transformations, the first two dimensions are actually necessary elements while the 'Postnational' and 'Regime' dimensions may or may not be present to the same extent in different forms of Competition States – so the latter will therefore be excluded from the present analysis. Furthermore, the key argument is precisely that the reforms in economic and social policies are connected so that a Competition State should display both Schumpeterian economic policies and workfarist social policies in order to qualify as a representative of the ideal-type.

Schumpeterian policies, according to the literature, are focused on promoting enterprise and innovation, as well as promoting foreign investment and fixing mobile capital within state's own economic spaces. This Schumpeterian moment thus includes:

- Providing business friendly environment
- Fixing mobile capital within state's economic spaces
- Supporting innovation and the shift from sunset to sunrise sectors through specific incentives (Jessop, 2002).

The extent to which states provide a business friendly environment is measured using the effective average tax rate on corporate income expressed as a proportion of the net present value of the income stream. The indicator is taken from Devereux et al (2008) and it is derived by considering a hypothetical investment and calculating the proportional difference of the net present value of a profitable investment project in the absence of tax and its net present value in the presence of tax. It is thus considered the best indicator for tax system attractiveness from the point of view of competitiveness (Deveraux et. al, 2008). It is also more appropriate than indicators based on actual tax revenues since, to the extent that 'competitive' tax regimes succeed in attracting investment, one would expect higher revenues from corporate taxes in these regimes.

According to the literature on tax competition (Genschel, 2001; Hines and Summer, 2009), the aim of attracting investment and fixing mobile capital within the national economic space is also reflected in the state emphasis on indirect rather than direct taxes. In the literature, one also often finds the assertion that capital mobility should lead to a shift in taxation from taxing capital to taxing labour; however, taxing labour in the form of social contributions or other taxes on wages at the same time increases labour costs and thus deters investment in that particular country. Increasing payroll taxes is, hence, not exactly the best strategy for avoiding potential losses associated with the initial decrease of capital tax rate; instead, the burden of taxation shifts to consumption taxes. The similar point was made by Hines and Summers (2009: 3) – in contemporary economy *all* states begin to behave like small open economies, and this has traditionally meant taxing consumption rather than capital. The consequence of this is that state tax systems tend to become less progressive - consumption taxes are assumed to be regressive as members of low income strata spend a higher proportion of their income on consumption, rather than investments or saving. Indeed, the share of total state revenues provided by consumption taxes is recognized in the literature as the best proxy for examining whether taxation in a particular country is regressive rather than progressive (Prasad and Deng, 2009). Shifts in tax policy have thus another implication for state redistribution – in addition to withdrawing from redistribution via direct cash benefits; the state also withdraws from redistribution via taxation. Hence, both through its social policy and its fiscal and economic policy, a Competition State basically redistributes resources from labour to capital and, in that sense, represents the inverse of a welfare state (to the extent that the latter indeed was a mechanism for striking 'social compromise' and a means of ensuring that some part of a country's economic growth is redistributed from capital to labour). The shift from direct to indirect taxation is measured using the share of consumption tax (VAT) as part of total tax revenue (source: European Commission, 2010). Since states with lower direct taxes might attract more investment and hence record lower levels of VAT as a share of total revenues, actual VAT rates instead of share in revenue would be a more desirable indicator. The problem is, however, that in many countries VAT rates are differential and the scope of products subject to lower VAT rates varies greatly, meaning that using tax rates would not give an accurate comparison among states; therefore the share of VAT in total revenues is used.

Besides the shift in taxation systems, another aspect of economic transnationalisation and locational competition for investments is the rise in investment incentives that governments offer to companies willing to invest in their territory. Basically, some states now actively subsidize either completely new investments, the expansion of existing production facilities or even the *status quo,* i.e. after threatening with relocation, the companies get subsidies simply for staying where they are. The practice of investment subsidies was well established in the US with studies documenting fierce competition among US states (LeRoy, 2005; Lowering 2003), but it has also become common in the EU (Thomas, 2000). Active state support for investment, as well as support for innovation and technological change, is measured using state aid for horizontal objectives (source: European Commission, State Aid Scoreboard). The European Union classifies aid into aid for specific sectors and aid for horizontal objectives which include: research, development and innovation; environment; small and medium enterprises, employment aid, training aid, regional aid not elsewhere classified, and other objectives. As the goal of the Competition State is precisely to foster innovation and enterprise, aid for horizontal objectives is the closest we can come to the measure of state active support for the Schumpeterian 'creative destruction'. The majority of FDI incentives also come in the form of regional development aid, which is again classified under horizontal objectives (Thomas, 2010: 100-101). Some of these incentives also occur under sectoral aid; however, including the latter would necessarily also include state aid for 'rescue and restructuring', i.e. 'sunset' sectors, rather than schemes for 'sunrise' sectors and foreign investment. Hence, although not perfect, aid for horizontal objectives is probably still the best available indicator showing active state involvement in investment support.

There are certainly other dimensions which are often considered important for increasing competitiveness and attracting FDI – infrastructure provision to the investors, or R&D policies easily come to mind. However, these are not included in the analysis separately since it is very difficult to empirically disentangle the provision of infrastructure or fostering R&D that would constitute in particular the support for private investment rather than being undertaken for other governmental goals (such as for instance strategic, or security goals). Furthermore, investment support in the form of the support for research and development as well as the provision of land equipped with infrastructure at discounted prices are also included in the state aid measurement so that the parts of R&D and infrastructure policies that are most directly related to the support for investment are actually included in the analysis.

As for the Workfare side of the Competition State, it implies social policies aimed at increasing labour market flexibility and employability, and turning the labour force into adaptable, entrepreneurial subjects by increasing and adjusting their skills as well as their work-incentives. Thus, contrary to the post-World War II welfare policies where decommodification was arguably one of the most important aspects, the Competition State model is focused on re-commodification, enhancing citizens' employability and making their incomes entirely dependent on market fluctuations. This, however, does not happen simply through the privatization of social services traditionally provided by the state, such as education, health care, and pensions. Rather, the relevant change is the one of shifting priorities from income protection deemed detrimental for work-incentives towards the provision of skills and measures to increase human capital. Furthermore, neoliberal logic assumes that the causes of unemployment are primarily the unwillingness of the workforce to either accept available jobs (at whatever wage the market would dictate), or to turn to entrepreneurship. Coupled with the anti-inflationary stance and the retreat of the state from using macroeconomic policies as a tool to remedy unemployment, this means that labour market policies shift from policies for the unemploy*ed* to policies for combating unemploy*ment*. One consequence is that requirements for acquiring unemployment benefits are becoming stricter, the duration of such benefits is shortening and the definition of an acceptable job that the unemployed person must take up if she does not want to lose her benefit is broadening in order to prevent the labour force from being too picky when entering the labour market. A similar reorientation is apparent in the social assistance policies aimed at the poorest social strata. These are increasingly being redefined as policies combating 'social exclusion' and are being aimed not only at providing income for the poor but also 'including' them in the labour market through tying the assistance with work-tests and a surveillance of the recipients' willingness to work.

In the literature these tendencies have been labelled as workfare policies or the increased productivism of social policy – and they imply primarily the changes in state *priorities*, rather than in absolute spending. In other words, welfare policy is changing from the 'nanny state' to the 'empowering' state paradigm – with empowerment understood primarily as the granting the ability to participate in the labour market. The relevant dimensions of policy change are thus:

- The creation of flexible labour markets
- Increasing labour supply and work-incentives of the workforce
- Prioritizing skills and human capital creation over income protection (Jessop, 2002).

The creation of flexible labour markets is measured using the index of strictness of employment protection legislation developed by the OECD (source OECD Social Expenditure Database; Romih and Festic, 2008). It represents the average of 3 subindices: a difficulty of hiring index, a rigidity of hours index and a difficulty of redundancy index. All these subindices are made up of several components and result in values between 0 and 6, with higher values indicating more rigid regulation.

Increasing work-incentives of the workforce is measured using several indicators:

- share of active labour market policy (including active labour market programmes and labour market administration) in total labour market expenditure (source: Eurostat and own calculation). Since the relevant issue is *priority* rather than absolute spending, a relative measure (i.e. the share in total labour market spending) is taken rather than an absolute measure. Hence, whether the state increases its active labour market spending, or simply cuts it much less than the spending on unemployment benefits, in both cases it is approaching the Competition State ideal type.
- spending on passive labour market measures adjusted for the unemployment rate (source: Eurostat). The indicator measures the generosity of the unemployment compensation system and, thereby, the concern with work-incentives of the labour force. Ideally, one would also include here other indicators such as the duration of unemployment benefits, or the definition of acceptable jobs the unemployed should accept in order not to lose the right to benefits. However, due to problems with data availability for detailed features of labour market policy, the share of active labour market

policy in total labour market spending and spending on passive policy adjusted for the unemployment rate will be used as a proxy for examining the extent to which states prioritize activation and recommodification over traditional income protection measures in labour policy.

- spending on other benefits accruing to the working-age population: family and children benefits, and social exclusion spending as percentage of GDP (source: Eurostat) – these two indicators again measure the concern with work-incentives, through measuring other forms of income protection for the working-age population.

As for the overall prioritizing of skills and human capital, it is measured by looking to total government education spending as a share of total public expenditure (source: Eurostat). The indicator measures the focus on human capital, which can come about either through increased spending on education or through less radical cuts in education than in other fields of state activities. While spending on labour market policies shows the priorities in the field that is most closely linked with participation in the labour market, education in total public expenditure shows prioritizing of human capital in the overall scope of state expenditure

The social policy side of Competition State – i.e. shift towards workfare – has already been analysed in works by Vis (2007) and Hudson and Kuhner (2007) that use fuzzy-sets analysis and focus on a number of OECD countries. Neither of these studies, however, includes the shifts in economic policy associated with a states' promotion of entrepreneurship or attempts to fix mobile capital within their own spaces. Furthermore, their focus is only on whether a certain state has experienced regime shift from welfare to workfare, while not examining the potential variety *among* workfare regimes. If, as Vis (2007) finds, Denmark and Ireland have indeed both shifted from welfare to workfare states, the persistently large differences in social generosity with which this workfarism is associated certainly suggest that they would represent different kinds of workfare states.

It should be noted here that dimensions related to Schumpeterian policies refer to the *structure* of the tax system, rather than total *size* of state revenues. Similarly the dimensions related to workfare policy reflect *priorities* rather than absolute social spending – hence, in line with the theory, the operationalization actually allows for the possibility of large and small; generous and less generous Competition States. In order to explore the possibility of variation among Competition States in terms of state size as well as social generosity, three additional indicators are included in the analysis:

- Total taxes (including social security contributions) as a percentage of GDP (source: European Commission, 2010) – since Competition State theory can include both big and small states, total tax revenues as a share of GDP should show whether the process in question is the one of a diminishing state, or a transformation without 'state shrinkage'

- Social expenditure as a share of GDP (source: Eurostat) – this is the standard indicator for the generosity of welfare states which should serve here to differentiate between generous and less generous Competition States, or in Torfing's terminology 'offensive' workfare from 'lean' or 'defensive' one (Torfing, 1999: 17).
- Public expenditure on pensions as a share of GDP (source: Eurostat). In the workfarist logic, pensions are less sensitive to cuts than other types of benefits since they are not directly detrimental for work-incentives (as opposed to unemployment benefits, for example). Since pensions are typically the biggest part of the overall social budget, they also serve to distinguish between more and less generous Competition States, rather than marking the presence or absence of such a shift.

The data for most of the above indicators come from Eurostat and the OECD Social Expenditure Database. The precise definition of variables and the sources are provided in the Appendix.

To summarize, according to the Competition State theory, all European states would be expected to experience a shift towards both Schumpeterian and workfarist policies. Although there might be variation with respect to their total state size or total social spending, they should all display: low corporate tax rates, a high reliance on indirect rather than direct taxes, high levels of horizontal state aid, high proportion of active policies amongst total labour market spending, a high share of total public spending going to education, low unemployment benefits expenditure, low spending on family policy, liberal labour legislation. In addition, these Competition States could still diverge in their overall levels of tax revenues or overall public and social spending – these differences would indicate the existence of various types of Competition States.

Welfare vs. Competition State – assessing the changes in Western Europe

In order to analyse the transformations of European states, this work uses cluster analysis– an exploratory research technique to identify groups in the observations. As stated above, the main goal of the quantitative part of the research is to analyse both Eastern and Western European states. However, since the theory of the Competition State has been developed primarily in the context of Western capitalist states that indeed were the ideal-typical Keynesian Welfare States – something that cannot be said for the socialist Eastern ones - the first step in the analysis was to focus only on the Western countries. This was done primarily in order to make sure that the results are not driven simply by the attempt to compare the uncomparable. In other words, to the extent that the analysis shows that groups of West European states are indeed changing over time, with some of them converging on the Competition State model, *and* as far as the inclusion of Eastern states does not change the results of the analysis, one can be more certain that the methodological strategy of treating the two European halves as comparable cases is indeed justified.

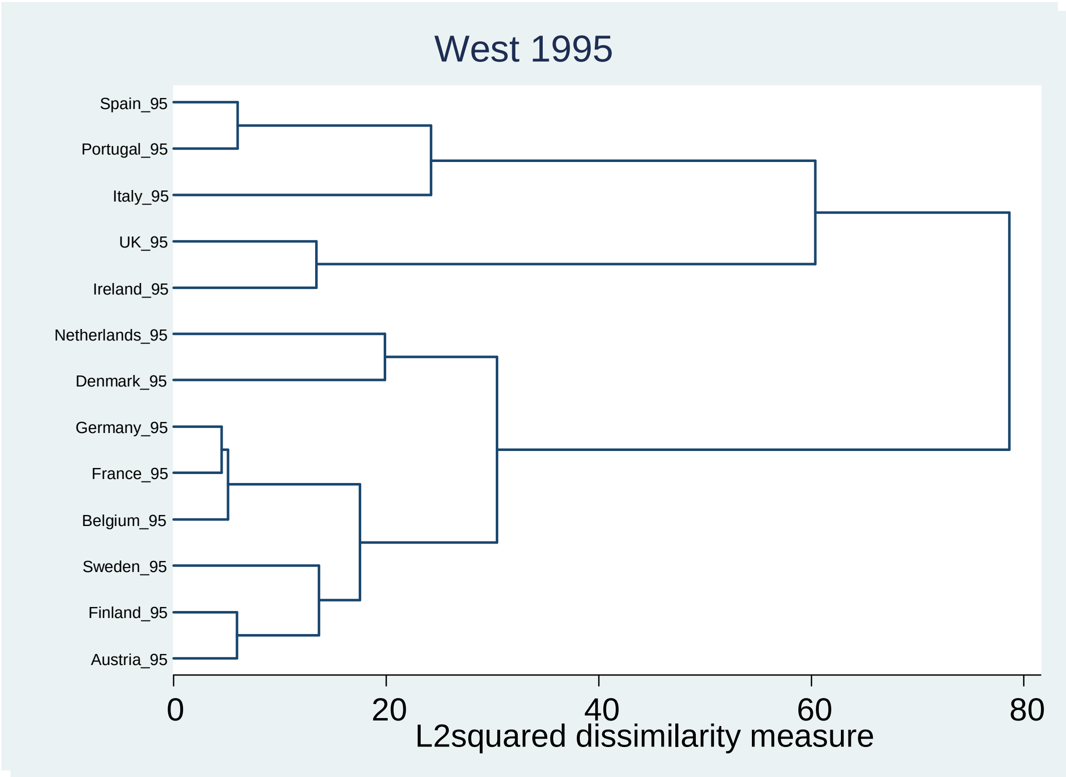
Cluster analysis as an exploratory technique is based on the matrix of similarities or dissimilarities between observations conceived as points in a multidimensional space. There are two main kinds of cluster analysis: partitioning and hierarchical. Partitioning clustering requires that the researcher posits the number of clusters *a priori* and then proceeds to iteratively move observations between clusters until the optimal allocation is identified. Hierarchical clustering does not require setting the number of clusters *a priori* and can proceed either through the divisive approach, beginning with all objects in one cluster and then subdividing them until each object is on its own, or through the agglomerative approach in which each object is regarded on its own and the objects are then combined into clusters (Everitt, 1993). Since in my analysis the number of clusters is not known *a priori*, I used agglomerative hierarchical clustering, with the goal of maximising within-cluster similarity and between-cluster difference. Several different agglomerative hierarchical linkage methods exist for establishing groups in the data – the most common one being Ward's method, which is designed to optimize the minimum variance within clusters and works by joining groups that result in the lowest increase in the sum of squared errors (Everitt, 1993; Aldenderfer and Blashfield, 1984). The analysis proceeds in three steps: 1) identifying the existence of groups in the observations, in my case countries; 2) determining the membership of countries to specific groups; 3) evaluating the characteristics of each cluster and its member countries to assess whether they display any systematic divergence.

Probably the most difficult step in the analysis is determining the actual number of groups identified in the data. This is typically done by applying some of the available stopping rules for cluster analysis. According to the Milligan and Cooper (1985) study, the best results are achieved by applying the Calinski and Harabasz stopping rule, as well as the Duda and Hart stopping rule. The Calinski and Harabasz stopping rule is based on calculating within- and between-cluster sum of squares for different numbers of clusters, and the number of groups is identified by the highest pseudo-F value, or the number at which the value of pseudo-F rapidly rises (Calinski and Harabasz, 1974). The Duda and Hart stopping rule is based on the ratio of the sum of squared errors within a cluster when the data are broken into two clusters and the squared errors when one cluster exists – Je(2)/Je(1). The conventional rule for deciding the number of groups is to determine the largest Je(2)/Je(1) value that corresponds to a low pseudo T-squared value and has a higher T-squared value above and below it. In determining the number of clusters, I applied both stopping rules – in most cases they both identified the same number of clusters. In cases when they suggested different numbers of clusters, but the difference between pseudo-F values in the Calinski and Harabasz rule was small, I relied on the Duda and Hart rule.

The first step in my quantitative research was to conduct cluster analysis of Western European countries using the data from the mid-1990s. As all of the above indicators are relevant for the established welfare regime and a variety of capitalism typologies, and as most studies using the data from early 1990s found that the two Varieties of Capitalism as well as different welfare regimes are still identifiable, this exercise served simply to see how the indicators used to assess the proximity to the Competition State model behave with respect to traditional typologies.

A hierarchical cluster analysis shows that there are 3 main groups of countries. Graph 1 presents the dendrogram obtained by the analysis.

Graph 1. Cluster analysis dendrogram, Western Europe 1995



Both stopping rules suggest that three is the optimal number of clusters. The following groups of countries were obtained:

Table 1. Clusters of states in Western Europe 1995

Western Europe in 1995 Country	Revenue as % of GDP	Effective average corporate tax rate	Share of VAT in total tax revenue	Horizontal aid as % of GDP	EPL	ALMP in total labour market policy	Education in total public expenditure	Social expenditure as % of GDP	Unemployment benefits as % of GDP adjusted for unemployment rate	Pension spending as % of GDP	Family and children benefits as % of GDP	Social Exclusion as % of GDP
Austria	41.4	29.7	18.6	0.22	2.21	19	10.78	28.9	0.41	14.9	3.2	0.31
Belgium	43.8	34.5	15.1	0.33	3.15	31	12.2	27.4	0.28	12	2.27	0.70
Denmark	48.8	30	19.4	0.42	2.4	29	12.98	31.9	0.64	9.6	3.8	1.35
Finland	45.7	25.9	17.4	0.48	2.33	27	11.49	31.5	0.25	12.9	4.1	0.64
France	42.7	39.8	17.3	0.22	2.98	44	11.27	30.3	0.14	13.3	2.9	0.35
Germany	39.8	41.2	16.3	0.45	3.17	34	9.7	28.3	0.29	12	2.2	0.24
Netherlands	40.2	32.3	16.2	0.15	2.73	33	8.98	30.6	0.42	11.5	1.3	1.47
Sweden	47.9	23.8	18.9	0.31	3.49	51	10.67	33.7	0.26	11.4	3.8	0.98
Continental	**43.8**	**32.2**	**17.4**	**0.32**	**2.8**	**33.5**	**11**	**30.3**	**0.34**	**12.2**	**2.9**	**0.8**
Italy	40.1	32	13.8	0.93	3.57	51	9.09	24.2	0.08	15	0.9	0.019
Portugal	32.1	33.4	22.2	0.17	4.1	37	11.92	20.4	0.12	9.9	1	0.07
Spain	32.7	36.5	15.9	0.23	3.82	15	10.36	21.6	0.13	10.6	0.4	0.12
Mediterranean	**35**	**34**	**17.3**	**0.44**	**3.8**	**34.3**	**10.5**	**22.1**	**0.11**	**11.8**	**0.8**	**0.1**
Ireland	33.1	9.4	21.2	0.21	0.93	34	12.22	18.8	0.21	5.1	2.1	0.34
UK	34.7	29.7	18.6	0.12	0.6	34	11.7	27.7	0.1	10.2	2.4	0.16
Anglo-Saxon	**33.9**	**19.6**	**19.9**	**0.17**	**0.8**	**34**	**12**	**23.3**	**0.16**	**7.7**	**2.3**	**0.2**

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD. The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data.

The three groups are Continental (with Scandinavian countries included), Mediterranean and Liberal cluster. Some variables are actually quite stable across the groups – the share of education in total public expenditure, or the share of ALMP in total labour market expenditure. Thus, the difference between the liberal and continental countries in the 1990s does not imply that one set are more productivist in their social policy outlook than the other. Other indicators, however, point to marked differences between these three clusters.

The Continental group has big states, high corporate taxes, a low share of VAT in total revenue, medium levels of state aid, medium rigidity of labour laws, very high overall social expenditure, and generous expenditure on unemployment benefits, pensions, family and children benefits as well as expenditure on combating social exclusion.

The second group are the three Mediterranean countries – smaller states, but with very high corporate taxes, very rigid employment protection legislation and high levels of horizontal state aid. These countries, however, have much lower levels of overall social spending. Furthermore, their spending is concentrated primarily on pensions where their generosity approximates the Continental model, while for all other social policies (unemployment benefits, family and children and social exclusion) they spend much lower shares of their GDP.

Finally, UK and Ireland represent the liberal cluster – small states, low corporate tax rates, a high share of VAT in total revenue, a low level of horizontal state aid, extremely liberal labour laws and low social spending. In contrast with the Mediterranean cluster, however, these countries have somewhat more balanced social spending – with lower expenditure on pensions and unemployment benefits and more on family benefits and social exclusion.

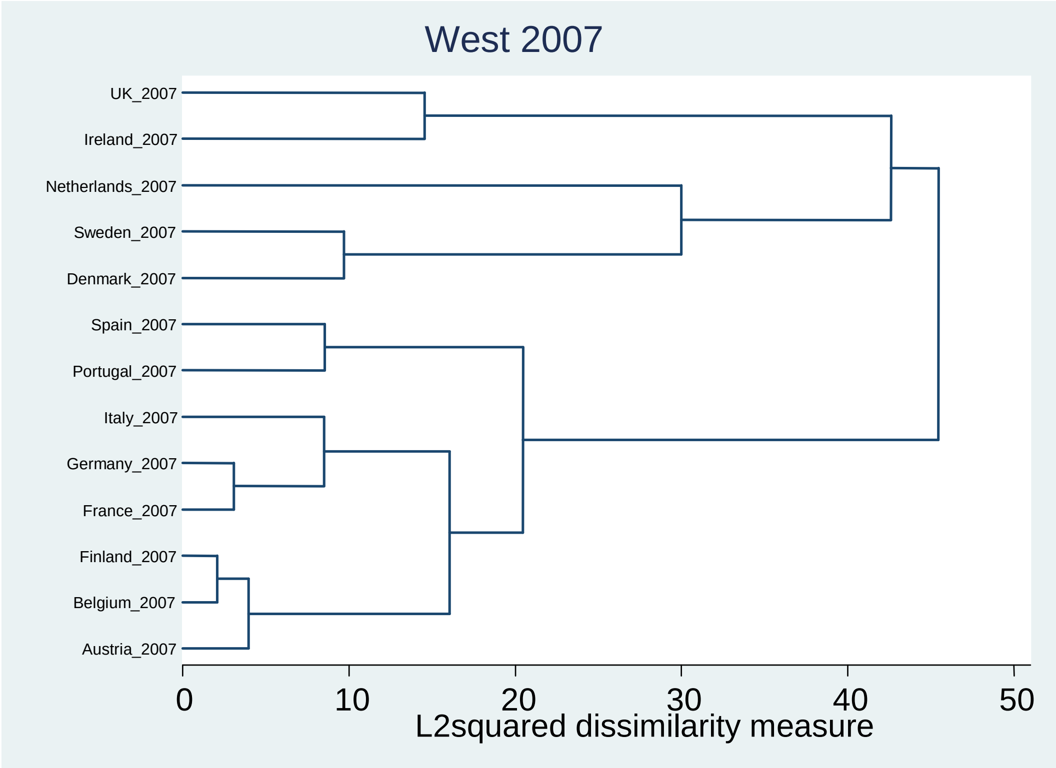
The results of the analysis do not correspond exactly to Esping-Andersens's typology, but the overall pattern is still familiar – the existence of Liberal, Mediterranean and Continental clusters does not come as a surprise to anyone familiar with comparative political economy – or even plain geography, for that matter. Their main characteristics in the field of social policy – strong employment protection and a marked pensions bias in social expenditure in the Mediterranean cluster, high but more balanced social expenditure in the Continental countries, liberal labour laws and overall low social spending in the Anglo-Saxon cluster – are also not particularly surprising. The analysis also shows that these models were associated with different tax regimes: high revenue collection, high corporate taxes and low reliance on VAT in the Continental cluster; low revenue collection, but high corporate taxes and low reliance on VAT in the Mediterranean cluster; and low revenue collection but strong reliance on VAT with low corporate taxes in the Liberal cluster. With respect to the levels of horizontal state aid, it is apparent that it was very high in the Mediterranean area, somewhat lower in the Continental cluster and very low in Anglo-Saxon countries. Thus, regarding the debate on the rise of the Competition State, it seems that in 1995 there was not yet any sign of it. High aid at the time goes hand in hand with high corporate taxes and very rigid labour laws; while countries that do maintain liberal labour laws and low corporate taxes offer very little aid for investment and innovation. In other words, while the idea of the Competition State would imply that states actively foster investment through investment subsidies, Liberal countries in the 1990s do not act in that way but simply do not intervene at all. Furthermore, their social policy is less generous, but not more productivist than the social policy of Continental or Mediterranean countries.

While in 1995 we cannot yet identify Competition State(s), the ideal type that comes out of the analysis is certainly the model of the European welfare state or European Social Model as exemplified in the big Continental cluster (comprising both the Continental-Conservative and Scandinavian welfare regimes). Indeed, the idea of European welfare states is conventionally understood precisely as the opposite of the Liberal or 'underdeveloped' Southern model, especially in the context of the (heavily normative) debates on the European Social Model as an ideal that the new EU member states should look up to. In this respect, the generous social protection, protective (or sclerotic) labour laws and relatively big state that characterise the big Continental cluster would all fit into the description of what makes Europe different from the US.

An important question is: how stable are these groups and their characteristics over time? Indeed, labour market policies are certainly one aspect of the entire welfare state architecture that has been subject to particularly deep changes in the last decade or so – with flexibility, activation and human capital investment becoming the new proclaimed goals of state social policy, endorsed by the parties of the right and the New Left alike. Similarly, fiscal policy and especially corporate taxation have also seen substantive reforms across Europe (Devereux, et al., 2008). Can the same groups of countries – and with the same characteristics – still be observed in the late 2000s?

The cluster analysis of Western European countries in 2007 gives us the following picture.

Graph 2. Cluster analysis dendrogram, Western Europe 2007



The Duda and Hart stopping rule suggests 4 groups of countries. The table below presents the characteristics of these groups of countries compared with the 1995 Continental cluster.

Table 2. Clusters of states in Western Europe 2007

Country	Revenue as % of GDP	Effective average corporate tax rate	VAT in % of total tax revenue	Horizontal aid as % of GDP	EPL	ALMP as % of total labour market spending	Education as % of total public spending	Social exp. as % of GDP	Unemployment benefits as % of GDP adjusted for unemployment rate	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. Exclusion as % of GDP
Austria	42.8	23	18.2	0.38	1.93	37	11.06	27.9	0.31	13.8	2.7	0.3
Belgium	44.3	25.4	15.8	0.35	2.18	39	12.44	26.8	0.29	10.7	2.1	0.66
Finland	43.1	24.5	19.4	0.43	1.96	38	12.48	25.4	0.21	10.6	2.9	0.55
France	42.8	34.6	16.4	0.37	3.05	41	10.69	30.5	0.15	13.3	2.4	0.45
Germany	39.3	35.5	17.9	0.5	2.12	42	10.29	27.7	0.15	12.4	2.8	0.17
Italy	42.8	31.8	13.8	0.24	1.89	36	8.96	26.7	0.12	14.6	1.2	0.053
Portugal	36.7	23.7	23.6	0.15	3.46	36	11.56	18.15	0.13	12.6	1.2	0.28
Spain	33.1	34.5	15.9	0.32	2.98	28	11.09	21	0.23	9	1.3	0.26
Eurozone cluster	**40.6**	**29.1**	**17.6**	**0.34**	**2.4**	**37.1**	**11.1**	**25.5**	**0.2**	**12.1**	**2.1**	**0.3**
Netherlands	39.1	23.7	18.6	0.25	1.95	45	11.69	28.3	0.45	12.1	1.6	1.68
Netherlands	**39.1**	**23.7**	**18.6**	**0.25**	**2**	**45**	**11.69**	**28.3**	**0.45**	**12.1**	**1.6**	**1.7**
Denmark	48.2	22.5	21	0.67	1.5	53	15.37	28.8	0.37	10.7	3.7	0.74
Sweden	47.1	24.6	20	0.82	1.87	68	12.74	29.1	0.07	11.6	2.9	0.58
New Scandinavian	**47.7**	**23.6**	**20.5**	**0.75**	**1.7**	**60.5**	**14.1**	**29**	**0.22**	**11.2**	**3.3**	**0.7**
UK	37.3	29.3	17	0.15	0.75	62	12.24	23.3	0.04	8.5	1.6	0.22
Ireland	29.3	14.4	24.4	0.32	1.11	41	13.52	18.9	0.07	5.2	2.6	0.36
Anglo-Saxon	**33.3**	**21.9**	**20.7**	**0.23**	**0.9**	**51.5**	**12.9**	**21**	**0.06**	**6.9**	**2.1**	**0.3**
1995 Continental	***43.8***	***32.2***	***17.4***	***0.32***	***2.8***	***33.5***	***11***	***30.3***	***0.34***	***12.2***	***2.9***	***0.8***

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD. The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

Similarly to the 1990s, in 2007 we can still distinguish the Liberal from the Continental countries. However, the special cluster of Mediterranean countries has disappeared and Italy, Portugal and Spain now converge with the rest of the Continental European Countries. On the other hand, three other countries leave the Continental cluster and develop their own distinct models with substantive differences from their previous models. Among these three countries, the Netherlands stands out as a cluster of its own, while Sweden and Denmark form the forth cluster. Perhaps one of the most interesting findings is that – apart from the Netherlands in its own separate cluster and Ireland which is still grouped with the UK – all of the Eurozone members have actually converged into a single cluster. For the time being, I will label these 4 groups of countries as the Eurozone cluster, the New Scandinavian cluster and the Liberal cluster, with the Netherlands as an outlier.

The Eurozone cluster is, from an economic policy perspective, very similar to the Continental cluster of 1995 – only with different country membership, since it now includes the Mediterranean countries. Compared with the Continental cluster of 1995, these countries have only slightly smaller states and lower corporate taxes, basically the same level of VAT as a share of total tax revenue and the same level of horizontal state aid. However, they do have somewhat more flexible labour laws and a more productivist labour market policy, a lower social expenditure as a percentage of GDP, and much lower expenditure on unemployment benefits, family benefits and social exclusion spending. Basically, the only thing that remains completely the same on the social policy side is the expenditure on pensions. Hence, we see that even countries that have not reformed their fiscal and investment regimes still became less generous and protective with their social policies. The disappearance of the separate Mediterranean cluster is due to several different processes. On the one hand, the Southern countries have converged with the Continental ones with respect to their economic policy specificities. They no longer provide exceptionally high levels of state aid, nor do they have markedly higher corporate tax rates (the reduction in corporate taxes is most pronounced in the case of Portugal which reduced its rate from 36% to only 23%). Nor have their labour laws remained so extremely protective. On the social expenditure side, however, the convergence comes about through the reforms in the 'old' Continental countries and their reduction of social expenditure generosity, rather than through any upward convergence of Mediterranean countries to the norm set by the Continental states. This is particularly apparent with respect to overall social spending, unemployment benefits generosity (with the biggest cuts being in Austria and Germany), and expenditure on pensions. However, with respect to social exclusion and family benefits policies, convergence comes about through changes in both directions: Mediterranean countries increasing and Northern Continental countries decreasing their generosity.

Compared with the rest of the Eurozone, as well as the old Continental cluster, the Netherlands does not depart much in terms of state size, but it does have lower corporate tax rate and a higher share of VAT in total revenues. However, it does not give higher horizontal aid for investments. Thus, the reforms on the economic policy side could be described as mild. The same goes for the social policy side: more flexible labour laws, somewhat more productivist labour market policy, very high spending on education, slightly lower social and family spending, but at the same time there is higher spending for unemployment benefits and social exclusion. Thus, the policy pattern of the Netherlands reflects a balanced approach to reforms as exemplified in its famous flexicurity model with unions agreeing to freeze wage increases in exchange for maintaining the level of social benefits that the government would otherwise have cut (Becker, 2004).

Liberal countries also maintain their core characteristics – small state, low corporate taxes, and relatively high share of VAT in revenues. Yet, compared to 1995, they now give much more state aid for innovations and investment. At the same time, their labour laws remain flexible, and their overall social policy tends more towards the workfarist / productivist direction: lower social expenditure, a radical decrease in unemployment spending, and a doubling of the shares of ALMP in total labour market spending, as well as a mild increase in the share of total public spending going to education (the latter is much more pronounced in Ireland). They also record only a slight decrease in expenditure on pensions, a small decrease in family benefits (more pronounced in UK than in Ireland) and, actually, an increase in social exclusion spending – particularly marked in UK. Thus, liberal countries, while maintaining the main features of their models, at the same time reformed their minimalistic states in line with the expectations of the Competition State theorists (which, it is interesting to note, primarily come from an Anglo-Saxon background themselves).

Finally, the New Scandinavian model is perhaps the most interesting to observe. It is marked by very big states, low corporate tax rates, a high share of VAT in total revenues, very high levels of horizontal aid, very flexible labour laws, and productivist – but still relatively generous – social spending.

Do we thus see signs of convergence? Actually, yes. Namely, the values of the dissimilarity measure (x-axis on dendrogram) are much higher in 1995 than in 2007. In other words, if, instead of applying stopping rules for determining the number of clusters, we had chosen to take 50 as the value of dissimilarity measure representing the cut-off point for clustering, in 1995 there would still be 3 clusters (Mediterranean, Liberal and Continental) but in 2007 all of Western Europe would belong to a single cluster.

However, more interesting than the convergence vs. divergence question are the changes we observe *within* the different models. The table below thus pulls together the changes over time in the different groups of countries. The groups are derived from the two previous analyses – Liberal countries; Mediterranean; Continental states that belong to the Continental cluster in both time periods; and the states that shift from Continental to different cluster membership in 2007.

Table 3. State transformation in Western Europe 1995-2007

Cluster	Revenue as % of GDP	Effective average corporate tax rate	VAT as % of total tax revenue	Horizontal aid as % of GDP	EPL	ALMP as % of total labour market spending	Education as % of total public spending	Social exp. as % of GDP	Unemployment benefits as % of GDP adjusted for the unemployment rate	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. Exclusion as % of GDP
Liberal 1995	33.9	19.6	19.9	0.17	0.8	34	12	23.3	0.16	7.7	2.3	0.2
Liberal 2007	33.3	21.9	20.7	0.23	0.9	51.5	12.9	21	0.06	6.9	2.1	0.3
Continental 1995	42.7	34.2	16.9	0.3	2.8	31	11.1	29.3	0.3	13	2.9	0.4
Continental 2007	42.5	28.6	17.5	0.4	2.2	39.4	11.4	27.7	0.2	12.2	2.6	0.4
Netherlands 95	40.2	32.3	16.2	0.15	2.7	33	8.98	30.6	0.42	11.5	1.3	1.5
Netherlands 2007	39.1	23.7	18.6	0.25	2	45	11.69	28.3	0.45	12.1	1.6	1.7
Mediterranean 1995	35	34	17.3	0.44	3.8	34.3	10.5	22.1	0.11	11.8	0.8	0.1
Mediterranean 2007	37.5	30	17.8	0.2	2.8	33.3	10.5	22	0.2	12.1	1.2	0.2
Scandinavia 1995	48.35	26.9	19.15	0.37	3	40	11.8	32.8	0.45	10.5	3.8	1.2
Scandinavia 2007	47.65	23.55	20.5	0.75	1.7	60.5	14.1	28.95	0.22	11.15	3.3	0.66

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD. The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

Starting with the Liberal model, it is apparent that their social policy as a whole has become more productivist and less generous than it used to be, with a particularly marked increase in spending on active labour market policies accompanied by a drop in spending on unemployment benefits. On the fiscal policy side, both corporate taxes and aids for investments have recorded slight increases, though they are still lower than in the other clusters. In other words, social policy reforms in Liberal countries do correspond to the Competition State theories, while the fiscal reforms only partly conform to the model due to the rise of corporate tax rates. However, this rise is driven primarily by Ireland which, despite the increase from 9% to 12% tax rate still has one of the lowest corporate taxes in Europe.

With respect to the Continental countries, their corporate tax rates are lower than in 1995; employment protection legislation is less rigid and expenditure on unemployment, family benefits and social exclusion is lower than it used to be. At the same time, however, they have also slightly increased their relative ALMP and education spending. Hence, the reforms tend towards the creation of a Competition State (lower taxes, higher aid, less social generosity and higher emphasis on human capital measures), but the changes are very small indeed.

Mediterranean countries, on the other hand, display the opposite pattern – lower taxes, but also lower aid, increased flexibility of labour law, but no increase in the relative spending on education and ALMP. At the same time, they are the only group that actually records increases in unemployment, pensions, family and social exclusion spending. Hence, in line with the earlier literature on the Europeanization of the European South leading to the increased generosity of their welfare states, Mediterranean states indeed seem to become more, rather than less, generous over time.

The Dutch reforms have already been discussed – lower taxes and higher aid, but at the same time increased welfare state generosity, as well as the increased emphasis on ALMP and education. Hence, the Netherlands represents a case of balanced reforms along the lines of the flexicurity model.

Two Scandinavian countries, by way of contrast, display more radical changes which set them apart from the rest of the Continental Europe. The shift is less apparent when it comes to fiscal policy, especially in Sweden whose taxation system was always 'light on producers, heavy on consumers' (Steinmo, 2010: 27). Both countries have only slightly reduced their revenues as a percentage of GDP and slightly increased the share of VAT in their total revenues; and only Denmark actually decreased its corporate taxes (from 30% to 22%). Still, as Steinmo correctly notes for the case of Sweden, these business-friendly taxes were traditionally part of the broader social compromise and were combined with generous labour-friendly policies – the policy of wage negotiation and, importantly, a generous system of unemployment compensation that made it easier for unions to recruit members through administering unemployment benefits in the so called Ghent system. The contemporary Scandinavian model, meanwhile, seems to be much less labour friendly than it was in the 1990s and even more business friendly than it used to be. In addition to providing a relatively favourable tax environment, Sweden and Denmark have also recorded the highest increase in horizontal aid awarded for investments – practically doubling it over the course of 10 years. On the other hand, reforms have also been introduced in their social policies, which now display increased productivism both in labour market policy and their overall budget, with education rising as a proportion of total public expenditure. Active labour market policies were always important in Scandinavia – however, they were previously combined with a very generous system of unemployment compensation, whereas the generosity of this system has now recorded a remarkable decline. While in 1995 Denmark was spending as much as 0.64 % of GDP per 1% unemployment rate, by 2007 it had fallen to only 0.37% (which is comparatively still high, but nevertheless represents barely half of what it used to be), with the respective figures for Sweden coming in at 0.26 in 1995 and 0.07 in 2007. This change also meant that the share of ALMP expenditure has increased, making up 68% of total labour market expenditure in Sweden and 53% in Denmark, whereas in 1995 the respective figures were 51% and 29%.

As for the other parts of their social spending, pensions actually recorded a small increase, but expenditure on all other items declined, with the changes more pronounced in Sweden than in Denmark. Social exclusion spending, for instance, decreased from 1.35% of GDP in Denmark and 0.98% in Sweden to only 0.74% and 0.58% respectively. At the same time, Sweden has also decreased its expenditure on family and children benefits. Hence, policies protecting the income of the working-age population turn out to be particularly vulnerable – precisely those schemes which should be the prime target of cuts according to the workfarist logic of social reforms. With both fiscal and social policies being reformed in the direction of increasing competitiveness, and with those reforms being profound enough to place Sweden and Denmark in a separate cluster, I would argue that they have indeed turned into Competition States.

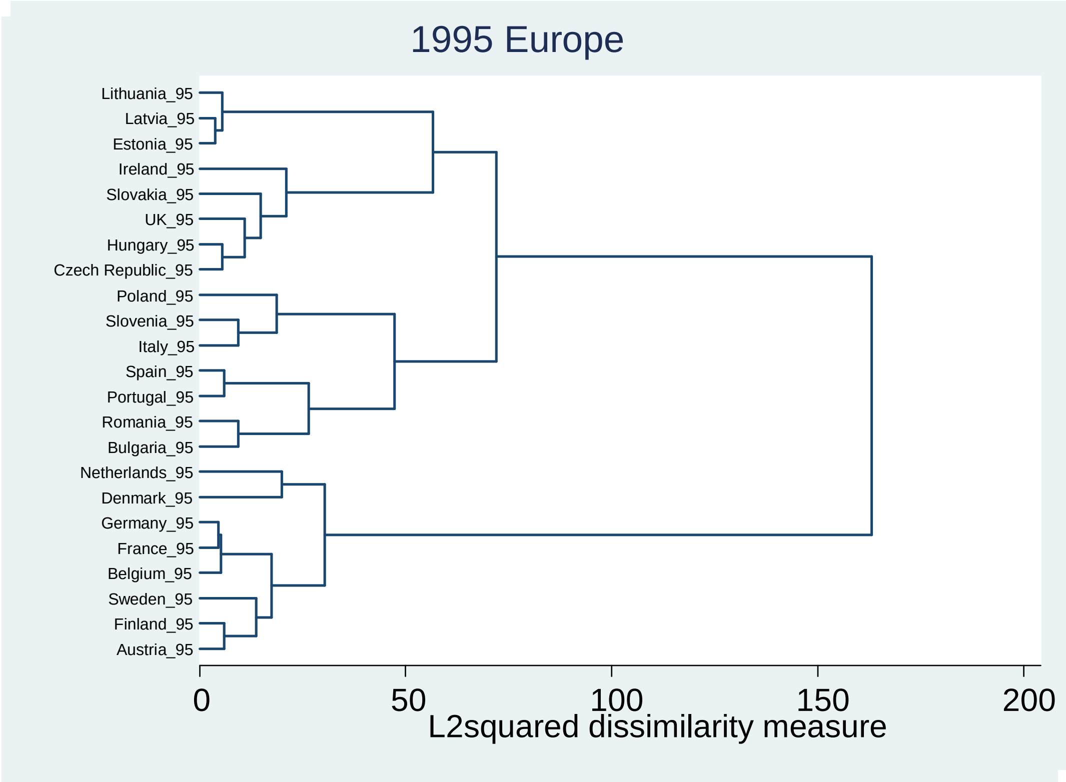
The above analysis thus shows that important changes have occurred on the map of the West European welfare states. For the majority of these states, the reforms indeed go in the direction that the Competition State theory would suggest – however, differences are apparent both in the direction of changes (with Mediterranean countries clearly departing from the overall trend), as well as in the depth of changes – with Sweden and Denmark transforming much more than the rest of Western Europe and really developing into Competition States. Yet, although differences can still be found among different groups of countries, it is important not to assume that in 2007 these represent the same welfare regimes with the same characteristics that were prevalent in the Golden Age of European welfare states.

Europeanization East

The previous analysis shows that Western Europe was indeed a 'moving target'. Therefore, it is also very unlikely that the Europeanization of Eastern European countries joining the EU would result in their convergence on anything like the post-War European welfare states established in the period of national capitalisms. On the one hand, in the course of integration with Western Europe their own versions of capitalism became primarily transnational capitalisms and, on the other hand, the EU itself has exerted normative and political influence in promoting a certain vision of 'competitiveness' as the goal of policy reforms in the acceding countries.
How did this dynamic play out in Eastern Europe? Does 'Europeanization' actually represent the building of Competition States in the East and does it give rise to one single or to several different policy models?

In order to answer these questions I first analyzed Eastern and Western European countries together using the data from 1995 – the point at which we can assume that the transformation from socialism to capitalism has largely been achieved in Eastern Europe so that we are indeed comparing *capitalist* states. The graph below represents the dendrogram obtained by using hierarchical cluster analysis.

Graph 3. Cluster analysis dendrogram, Europe 1995



The optimal number of clusters according to both stopping rules is two – one cluster comprises Western Continental welfare states, while the other consists of Eastern European, Mediterranean and Liberal countries. The clusters are presented in the table below.

Table 4. Clusters of states, Europe 1995 – 2 groups

Country	Revenue as % of GDP	Effective average corporate tax rate	VAT as % of total tax revenue	Horizontal aid as % of GDP	EPL	ALMP as % of total labour market spending	Education as % of total public spending	Social exp. as % of GDP	Unemployment benefits as % of GDP adjusted for unemployment rate	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. Exclusion as % of GDP
Austria	41.4	29.7	18.6	0.22	2.21	19	10.78	28.9	0.41	14.9	3.2	0.31
Belgium	43.8	34.5	15.1	0.33	3.15	31	12.2	27.4	0.28	12	2.27	0.70
Denmark	48.8	30	19.4	0.42	2.4	29	12.98	31.9	0.64	9.6	3.8	1.35
Finland	45.7	25.9	17.4	0.48	2.33	27	11.49	31.5	0.25	12.9	4.1	0.64
France	42.7	39.8	17.3	0.22	2.98	44	11.27	30.3	0.14	13.3	2.9	0.35
Germany	39.8	41.2	16.3	0.45	3.17	34	9.7	28.3	0.29	12	2.2	0.24
Netherlands	40.2	32.3	16.2	0.15	2.73	33	8.98	30.6	0.42	11.5	1.3	1.47
Sweden	47.9	23.8	18.9	0.31	3.49	51	10.67	33.7	0.26	11.4	3.8	0.98
Average	**42.8**	**31.9**	**17.5**	**0.3**	**2.6**	**33.6**	**11.1**	**30**	**0.3**	**12**	**2.9**	**0.7**
Bulgaria	31.2	28.6	26.3	0.24	2.8	21	9.38	9	0.03	7.3	0.6	0
Czech Republic	36.2	26.4	17.3	0.34	1.9	52	8.5	17.4	0.04	9	2	0.221
Estonia	36.3	22.4	26.5	0.1	2.4	54	13.42	15.9	0.01	7	1.6	0.33
Hungary	40.8	19	18.4	0.3	1.27	32	9.34	20.3	0.12	9.7	2.6	0.18
Ireland	33.1	9.4	21.2	0.21	0.93	34	12.22	18.8	0.21	5.1	2.1	0.34
Italy	40.1	32	13.8	0.93	3.57	51	9.09	24.2	0.08	15	0.9	0.02
Latvia	33.2	22.7	27.8	0.03	2.5	54	15.62	17.5	0.03	10.2	1.5	0.11
Lithuania	27.5	23	26.9	0.01	2.7	54	14.07	13	0.01	6.2	1	0.59
Poland	37.1	32.4	16.8	0.66	1.4	18	10.02	19.7	0.06	14.4	1	0.11
Portugal	32.1	33.4	22.2	0.17	4.1	37	11.92	20.4	0.12	9.9	1	0.07
Romania	29.1	23.1	18	0.62	1.9	14	9.03	13	0.04	5.1	1.5	0.08
Slovakia	40.3	36.7	20.8	0.31	1.8	64	9.2	18.5	0.04	9.1	2.5	0.82
Slovenia	39.2	20.9	12.5	0.68	3.3	49	12.39	23.5	0.11	13.6	1.9	0.42
Spain	32.7	36.5	15.9	0.23	3.82	15	10.36	21.6	0.13	10.6	0.4	0.12
UK	34.7	29.7	18.6	0.12	0.6	34	11.7	27.7	0.1	10.2	2.4	0.16
Average	**34.9**	**26.4**	**20.2**	**0.3**	**2.3**	**38.9**	**11.1**	**18.7**	**0.1**	**9.5**	**1.5**	**0.2**

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD, Romih and Festic (2008). The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

The main difference between the clusters is that the second cluster consists of much smaller states with far lower social commitments. They also have somewhat lower corporate taxes and a higher reliance on VAT as a source of state revenues; a slightly higher share of total labour market spending goes to ALMP, and they have much lower spending on all social expenditure items. Thus, compared with Western European states, Eastern European ones in mid-1990s all belong to the same cluster. Furthermore, the inclusion of the Eastern Europeans in the analysis results in the formation of a joint cluster with both Mediterranean and Liberal countries, since the remarkable difference in welfare state generosity is now the most important differentiating factor between the clusters.

Bearing in mind this major divide between generous and non-generous welfare states, we may still be interested in a more refined differentiation. Both the dendrogram and the Duda and Hart rule suggest that the second best solution would be to divide the countries into five clusters – and the table below gives the results for these five clusters.

Table 5. Clusters of states in Europe 1995 – 5 groups

Country	Revenue as % of GDP	Effective average corporate tax rate	VAT as % of total tax revenue	Horizontal aid	EPL	ALMP as % of total LM spending	Education as % of total public spending	Social exp. as % of GDP	Adjusted unemployment benefits	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. Exclusion as % of GDP
Austria	41.4	29.7	18.6	0.22	2.21	19	10.78	28.9	0.41	14.9	3.2	0.31
Belgium	43.8	34.5	15.1	0.33	3.15	31	12.2	27.4	0.28	12	2.27	0.70
Denmark	48.8	30	19.4	0.42	2.4	29	12.98	31.9	0.64	9.6	3.8	1.35
Finland	45.7	25.9	17.4	0.48	2.33	27	11.49	31.5	0.25	12.9	4.1	0.64
France	42.7	39.8	17.3	0.22	2.98	44	11.27	30.3	0.14	13.3	2.9	0.35
Germany	39.8	41.2	16.3	0.45	3.17	34	9.7	28.3	0.29	12	2.2	0.24
Netherlands	40.2	32.3	16.2	0.15	2.73	33	8.98	30.6	0.42	11.5	1.3	1.47
Sweden	47.9	23.8	18.9	0.31	3.49	51	10.67	33.7	0.26	11.4	3.8	0.98
Continental	**42.8**	**31.9**	**17.5**	**0.3**	**2.6**	**33.6**	**11.1**	**30**	**0.31**	**12**	**2.9**	**0.7**
Bulgaria	31.2	28.6	26.3	0.24	2.8	21	9.38	9	0.03	7.3	0.6	0
Romania	29.1	23.1	18	0.62	1.9	14	9.03	13	0.04	5.1	1.5	0.08
Portugal	32.1	33.4	22.2	0.17	4.1	37	11.92	20.4	0.12	9.9	1	0.07
Spain	32.7	36.5	15.9	0.23	3.82	15	10.36	21.6	0.13	10.6	0.4	0.12
South 1	***31.3***	***30.4***	***20.6***	***0.3***	***3.2***	***21.8***	***10.2***	***16***	***0.1***	***8.2***	***0.9***	***0.1***
Italy	40.1	32	13.8	0.93	3.57	51	9.09	24.2	0.08	15	0.9	0.02
Poland	37.1	32.4	16.8	0.66	1.4	18	10.02	19.7	0.06	14.4	1	0.11
Slovenia	39.2	20.9	12.5	0.68	3.3	49	12.39	23.5	0.11	13.6	1.9	0.42
South 2	***38.8***	***28.4***	***14.4***	***0.8***	***2.8***	***39.3***	***10.5***	***22.5***	***0.1***	***14.3***	***1.3***	***0.2***
Czech Republic	36.2	26.4	17.3	0.34	1.9	52	8.5	17.4	0.04	9	2	0.22
Hungary	40.8	19	18.4	0.3	1.27	32	9.34	20.3	0.12	9.7	2.6	0.17
Ireland	33.1	9.4	21.2	0.21	0.93	34	12.22	18.8	0.21	5.1	2.1	0.34
Slovakia	40.3	36.7	20.8	0.31	1.8	64	9.2	18.5	0.04	9.1	2.5	0.82
UK	34.7	29.7	18.6	0.12	0.6	34	11.7	27.7	0.1	10.2	2.4	0.16
Liberal	***37***	***24.2***	***19.3***	***0.3***	***1.3***	***43.2***	***10.2***	***20.5***	***0.1***	***8.6***	***2.3***	***0.3***
Estonia	36.3	22.4	26.5	0.1	2.4	54	13.42	15.9	0.01	7	1.6	0.33
Latvia	33.2	22.7	27.8	0.03	2.5	54	15.62	17.5	0.03	10.2	1.5	0.11
Lithuania	27.5	23	26.9	0.01	2.7	54	14.07	13	0.01	6.2	1	0.59
Baltic	***32.3***	***22.7***	***27.1***	***0***	***2.5***	***54***	***14.4***	***15.5***	***0.02***	***7.8***	***1.4***	***0.3***
East/South/Liberal	**34.9**	**26.4**	**20.2**	**0.3**	**2.3**	**38.9**	**11.1**	**18.7**	**0.1**	**9.5**	**1.5**	**0.2**

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD, Romih and Festic (2008). The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

Slovenia and Poland are similar to Italy – with high corporate taxes, high levels of state aid, and high expenditure on pensions, but much less generosity regarding other social benefits.
Bulgaria and Romania are similar to Spain and Portugal – being set apart from the above group primarily by a much lower level of state aid and also lower expenditure on pensions.
The Czech Republic, Slovakia, and Hungary resemble the Anglo-Saxon liberal model: lower corporate taxes, a higher share of revenues coming from VAT, medium levels of state aid (higher in the Eastern part of the cluster), very flexible labour laws, lower social and unemployment expenditure, lower expenditure on pensions and (within the framework of not particularly generous welfare states) somewhat higher spending on social exclusion and family benefits.
Finally, the Baltic cluster is marked by low corporate tax rates, a very high share of VAT in total revenues, very low levels of state aid, medium level rigid EPL, a productivist pattern of labour market spending, education forming a very high share of total public expenditure, very low social expenditure and, finally, a practically non-existent unemployment protection system. Apart from the more rigid EPL – a puzzling aspect indeed - one might actually consider this cluster to represent an extremely liberal group of countries. Also, in comparison with the Anglo-Eastern cluster (or with the purely Anglo-Saxon Liberal cluster from the analysis of Western Europe in 1995), these countries are both liberal *and* productivist – they have much higher proportions of total public expenditure going to education, as well as higher share of ALMP in total labour market policy. Hence, even as early as 1995 the Baltic states had come close to the Competition State model.

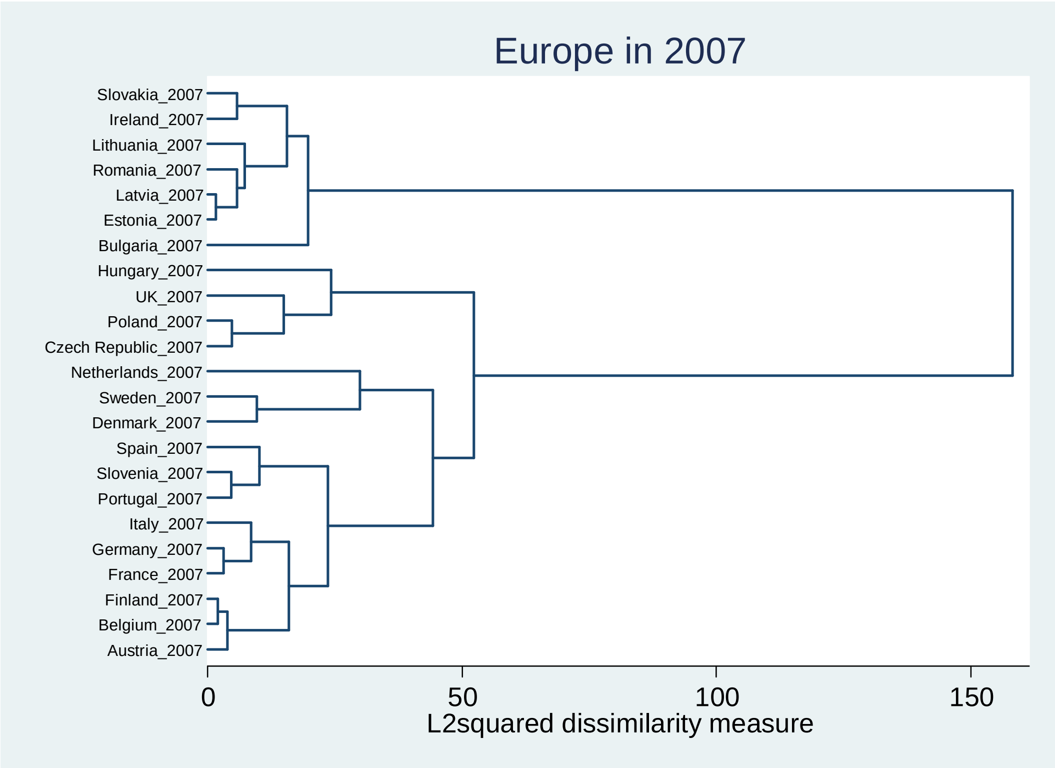
Thus, we see that, in 1995, Eastern European fiscal and labour policy in general approaches either the Mediterranean or the Liberal model, or represents a particularly radical liberal and productivist version thereof. In comparison with generous Western European welfare states, however, all of these groups appear as very different species indeed.

What happened in the 10 years after the Eastern enlargement took place? Partly based on the experience of the Mediterranean countries, the bulk of the literature expected that the new member states would become Europeanized, developing some kind of a 'European Social Model'. However, as we have seen from the earlier analysis, Western Europe was itself in the process of transformation and, by the time of the big Eastern enlargement, had changed quite many aspects of its previous Social Model.

As elaborated earlier, my expectation is that to the extent that there were pressures and changes apparent in Western European fiscal and social policies, the same factors will be particularly pronounced in Eastern Europe. In other words, the trends observable in the West should be played out more strongly in the East, so that Eastern Europe would not only converge on the model of the new West, rather than old, but would also go even further in the reforms aimed at 'increasing competitiveness'.

In order to see whether this was indeed the case, I again conducted a cluster analysis for Eastern and Western policies in 2007. The dendrogram is given in the graph below.

Graph 4. Cluster analysis dendrogram, Europe 2007



From the graph, it is clear that the most important division in 2007 lies between hyper-neoliberal Eastern countries (plus Ireland), on the one hand, and the Western European countries plus some Eastern ones on the other. According to both stopping rules, the optimal number of clusters is two.

The table below gives the results for these two clusters.

Table 6. Clusters of states in Europe 2007 – 2 groups

Country	Revenue as % of GDP	Effective average corporate tax rate	VAT as % of total tax revenue	Horizontal aid as % of GDP	EPL	ALMP as % of total labour market spending	Education as % of total public spending	Social exp. as % of GDP	Adjusted unemployment benefits spending as % of GDP	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. exclusion as % of GDP
Austria	42.8	23	18.2	0.38	1.93	37	11.06	27.9	0.31	13.8	2.7	0.30
Belgium	44.3	25.4	15.8	0.35	2.18	39	12.44	26.8	0.29	10.7	2.1	0.66
Czech Republic	36.1	21	19.5	0.73	1.96	55	9.87	18.6	0.04	8.2	1.7	0.19
Denmark	48.2	22.5	21	0.67	1.5	53	15.37	28.8	0.37	10.7	3.7	0.74
Finland	43.1	24.5	19.4	0.43	1.96	38	12.48	25.4	0.21	10.6	2.9	0.55
France	42.8	34.6	16.4	0.37	3.05	41	10.69	30.5	0.15	13.3	2.4	0.45
Germany	39.3	35.5	17.9	0.5	2.12	42	10.29	27.7	0.15	12.4	2.8	0.17
Hungary	40.4	19.5	19.3	1.47	1.65	45	10.45	22.4	0.04	10.4	2.8	0.14
Italy	42.8	31.8	13.8	0.24	1.89	36	8.96	26.7	0.12	14.6	1.2	0.05
Netherlands	39.1	23.7	18.6	0.25	1.95	45	11.69	28.3	0.45	12.1	1.6	1.68
Poland	34.3	17.4	23.4	0.75	1.9	62	11.65	18.15	0.05	11.6	0.8	0.17
Portugal	36.7	23.7	23.6	0.15	3.46	36	11.56	23.97	0.13	12.6	1.2	0.28
Slovenia	37.3	20.7	22.6	0.42	2.51	42	12.24	21.3	0.11	9.7	1.7	0.48
Spain	33.1	34.5	15.9	0.31	2.98	28	11.09	21	0.23	9	1.3	0.26
Sweden	47.1	24.6	20	0.83	1.87	68	12.74	29.1	0.07	11.6	2.9	0.58
UK	37.3	29.3	17	0.15	0.75	62	12.24	23.3	0.04	8.5	1.6	0.22
Average	**40.3**	**25.7**	**18.9**	**0.5**	**2.1**	**45.6**	**11.6**	**25**	**0.17**	**11.2**	**2.1**	**0.4**
Bulgaria	33.3	8.8	34.5	0.11	2	72	9.97	14.15	0.03	6.9	1.2	0.34
Estonia	32.2	17.3	24.9	0.09	2.1	54	13.94	12.3	0.02	5.9	1.4	0.07
Ireland	29.3	14.4	24.4	0.32	1.11	41	13.52	18.9	0.07	5.2	2.6	0.36
Latvia	28.9	14.3	23	0. 2	2.5	45	13.95	11.2	0.05	5.3	1.2	0.11
Lithuania	30.3	15.2	26.6	0.53	2.8	69	13.39	14.5	0.05	6.6	1.2	0.18
Romania	28	14.8	28.2	0.1	2.8	45	11.78	13.6	0.03	6.3	1.7	0.44
Slovakia	29.1	16.8	23.6	0.35	1.44	36	10.52	16	0.04	7.3	1.5	0.5
Average	**30.2**	**14.5**	**26.5**	**0.2**	**2.1**	**51.7**	**12.4**	**14.4**	**0.04**	**6.2**	**1.5**	**0.3**

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD, Romih and Festic (2008). The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

The most important difference from the 1995 results comes from the fact that all the Eastern European countries are no longer in the same cluster. Instead, we see Slovenia, Hungary, Czech Republic and Poland actually appearing more similar to Western European states than to Slovakia, Southeast European states or the Baltics. The dividing line, however, does not run simply between East and West, since Ireland is in the same group as the extremely neoliberal Eastern European states. In comparison with the West, the latter group is marked by very small states, extremely low corporate taxes, a high share of VAT in state revenues, a more productivist labour market and social spending, and very low expenditure on all social items. However, these states do not give higher aid to enterprises and do not have more flexible labour laws.

Again, if we want to go into further differentiation, the second-best number of clusters suggested by the two stopping rules is five. The table below gives the results for these five clusters, compared with the Continental cluster from 1995.

Table 7. Clusters of states in Europe 2007 – 5 groups

Country	Revenue as % of GDP	Effective average corporate tax rate	VAT as % of total tax revenue	Aid as % of GDP	EPL	ALMP as % of total labour market spending	Education as % of total public spending	Social exp. as % of GDP	Adjusted unemployment benefits as % of GDP	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. exclusion as % of GDP
Bulgaria	33.3	8.8	34.5	0.11	2	72	9.97	14.15	0.03	6.9	1.2	0.34
Estonia	32.2	17.3	24.9	0.09	2.1	54	13.94	12.3	0.02	5.9	1.4	0.07
Ireland	29.3	14.4	24.4	0.32	1.11	41	13.52	18.9	0.07	5.2	2.6	0.36
Latvia	28.9	14.3	23	0.20	2.5	45	13.95	11.2	0.05	5.3	1.2	0.11
Lithuania	30.3	15.2	26.6	0.53	2.8	69	13.39	14.5	0.05	6.6	1.2	0.18
Romania	28	14.8	28.2	0.10	2.8	45	11.78	13.6	0.03	6.3	1.7	0.44
Slovakia	29.1	16.8	23.6	0.35	1.44	36	10.52	16	0.04	7.3	1.5	0.50
Low-road Competition States	**30.2**	**14.5**	**26.5**	**0.2**	**2.1**	**51.7**	**12.4**	**14.4**	**0.04**	**6.2**	**1.5**	**0.3**
Czech Republic	36.1	21	19.5	0.73	1.96	55	9.87	18.6	0.04	8.2	1.7	0.19
Hungary	40.4	19.5	19.3	1.47	1.65	45	10.45	22.4	0.04	10.4	2.8	0.14
Poland	34.3	17.4	23.4	0.75	1.9	62	11.65	18.15	0.05	11.6	0.8	0.17
UK	37.3	29.3	17	0.15	0.75	62	12.24	23.3	0.04	8.5	1.6	0.22
High-road Competition States	***37***	***21.8***	***19.8***	***0.8***	***1.6***	***56***	***11.1***	***20.6***	***0.04***	***9.7***	***1.7***	***0.2***
Netherlands	***39.1***	***23.7***	***18.6***	***0.25***	***1.95***	***45***	***11.69***	***28.3***	***0.45***	***12.1***	***1.6***	***1.67***
Denmark	48.2	22.5	21	0.67	1.5	53	15.37	28.8	0.37	10.7	3.7	0.74
Sweden	47.1	24.6	20	0.83	1.87	68	12.74	29.1	0.07	11.6	2.9	0.58
New Scandinavian	***47.7***	***23.6***	***20.5***	***0.75***	***1.7***	***60.5***	***14.1***	***29***	***0.22***	***11.2***	***3.3***	***0.7***
Austria	42.8	23	18.2	0.378	1.93	37	11.06	27.9	0.31	13.8	2.7	0.3
Belgium	44.3	25.4	15.8	0.35	2.18	39	12.44	26.8	0.29	10.7	2.1	0.66
Finland	43.1	24.5	19.4	0.43	1.96	38	12.48	25.4	0.21	10.6	2.9	0.55
France	42.8	34.6	16.4	0.37	3.05	41	10.69	30.5	0.15	13.3	2.4	0.45
Germany	39.3	35.5	17.9	0.50	2.12	42	10.29	27.7	0.15	12.4	2.8	0.17
Italy	42.8	31.8	13.8	0.24	1.89	36	8.96	26.7	0.12	14.6	1.2	0.05
Portugal	36.7	23.7	23.6	0.15	3.46	36	11.56	18.15	0.13	12.6	1.2	0.28
Spain	33.1	34.5	15.9	0.32	2.98	28	11.09	21	0.23	9	1.3	0.26
Slovenia	37.3	20.7	22.6	0.42	2.51	42	12.24	21.3	0.11	9.7	1.7	0.48
New Continental	***40.2***	***28.2***	***18.2***	***0.3***	***2.5***	***37.7***	***11.2***	***25.1***	***0.2***	***11.9***	***2***	***0.4***
West & Visegrad	**40.3**	**25.7**	**18.9**	**0.5**	**2.1**	**45.6**	**11.6**	**25**	**0.17**	**11.2**	**2.1**	**0.4**

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD, Romih and Festic (2008). The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

With the more refined differentiation, the composition of clusters obtained by analysing only Western countries did not change substantively – the Eurozone cluster (also including Slovenia which, in 2007, was the first East European country to join the Eurozone) and the New Scandinavian cluster are still apparent, as well as the separate case of the Netherlands. The only difference is that the UK and Ireland now belong to two different clusters.

The fact that including East European countries in the analysis has not changed the results substantively already shows that the results are fairly robust. However, since hierarchical cluster analysis is sensitive to outliers, I repeated the analysis excluding the Netherlands in order to further validate the results of the analysis – the results have remained the same. Furthermore, I also reran the analysis using average linkage instead of wards linkage type of cluster analysis. Since two clustering procedures will typically generate different groups, obtaining similar results can also be taken as a support for the validity of the results (Everitt, 1993). The only difference using the average linkage type of cluster analysis was the separation of Hungary into a separate cluster, while all the other groups remained the same. Hence, validation procedures suggest that the results can indeed be considered robust.

Since the characteristics of the New Scandinavian, Eurozone, and Low-Road Competition State clusters (as well as the Netherlands) have been already discussed, here I will focus only on the cluster comprising Czech Republic, Hungary, Poland and the UK. This group is marked by smaller states than the Continental cluster (either the old or new one), lower corporate tax rates, higher shares of VAT in state revenues, much higher levels of state aid to enterprises, much more flexible labour laws, activist labour market policies, and lower social expenditure, particularly unemployment benefits spending.

The analysis shows that, in comparison with the situation in 1995, the Czech Republic, Slovenia, Hungary and Poland have converged with the Western European countries, but that there are still marked differences between the Visegrad states and Slovenia. This convergence could come about either through the upward convergence of Eastern welfare states towards the models of the Western ones (expected in the Europeanization thesis), or through the downward convergence of the Western states (foreseen by the 'enlargement as social dumping' thesis), or through some combination of both. In order to see which of these is true, the table below shows the development over time for Slovenia, for the three Visegrad countries and Western Continental countries.

Table 8. Transformations of selected West and East European states 1995-2007

Country	Revenue as % of GDP	Effective average corporate tax rate	VAT as % of total tax revenue	Aid as % of GDP	EPL	ALMP as % of total labour market spending	Education as % of total public spending	Social exp. as % of GDP	Adjusted unemployment benefits as % of GDP	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. exclusion as % of GDP
Slovenia_95	39.2	20.9	12.5	0.7	3.3	49	12.4	23.5	0.11	13.6	1.9	0.4
Slovenia_2007	37.3	20.7	22.6	0.4	2.5	42	12.2	21.3	0.11	9.7	1.7	0.5
Visegrad 3 average 1995	38	25.9	17.5	0.4	1.5	34	9.3	19.1	0.07	11	1.9	0.2
Visegrad 3 average 2007	36.9	19.3	20.7	1	1.8	54	10.7	19.7	0.04	10.1	1.8	0.2
1995 Continental	43.8	32.2	17.4	0.3	2.8	33.5	11	30.3	0.34	12.2	2.9	0.8
2007 Continental	40.6	29.1	17.6	0.3	2.4	37.1	11.1	25.5	0.20	12.1	2.1	0.3

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD, Romih and Festic (2008). The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

All three groups record a small decrease of revenues as a percentage of GDP, a drop in corporate tax rates, and an increase in VAT as a share of total revenues. The fiscal policy trends are thus equidirectional – the only exception being that the level of state aid decreased in Slovenia and increased in both Visegrad and Western states. The convergence thus comes about primarily through the changes in welfare state variables – and it is actually the downward trend in the West that stands out the most. Reductions in social spending – particularly unemployment, social exclusion and family benefits spending in the West – are much more marked than the rise of social generosity in the East. Hence, the convergence between Western and some Eastern European countries appears to be much more the result of the transformations of the West than any adoption of a European Social Model on the part of the Eastern member states.

In fact, if Europeanization has exerted any influence in the region, it seems to have primarily resulted in a remarkable divergence among the Eastern European states. In order to see how this divergence develops over time, the table below presents data for Eastern European groups of countries at different points in time. The groups in the table are derived from the results of the earlier cluster analysis.

Table 9. Transformations of East European states 1995-2007

Country	Revenue as % of GDP	Effective average corporate tax rate	VAT as % of total tax revenue	Aid as % of GDP	EPL	ALMP as % of total labour market spending	Education as % of total public spending	Social exp. as % of GDP	Adjusted unemployment benefits as % of GDP	Pensions as % of GDP	Family and children benefits as % of GDP	Soc. exclusion as % of GDP
Slovenia_95	39	21	13	0.7	3.3	49	12	24	0.11	14	2	0.4
Slovenia_2007	37	21	23	0.4	2.5	42	12	21	0.11	10	2	0.5
Bulgaria & Romania 95	30	26	22	0.4	2.4	18	9	11	0.04	6	1	0.04
Bulgaria & Romania 2007	31	12	31	0.1	2.4	59	11	14	0.03	7	2	0.4
Baltic 1995	32	23	27	0.05	2.5	54	14	16	0.02	8	1	0.3
Baltic 2007	31	16	25	0.3	2.5	56	14	13	0.04	6	1	0.1
Slovakia_95	40	37	21	0.3	1.8	64	9	19	0.04	9	3	0.8
Slovakia_2007	29	17	24	0.4	1.4	36	11	16	0.04	7	2	0.5
Visegrad 3 1995	38	26	18	0.4	1.5	34	9	19	0.07	11	2	0.2
Visegrad 3 2007	37	19	21	1	1.8	54	11	20	0.04	10	2	0.2

Source: Eurostat, Deveraux et. al. (2008), European Commission State Aid Scoreboard, OECD, Romih and Festic (2008). The relative measures of ALMP in total labour market spending, as well as spending on unemployment benefits adjusted for unemployment rate are own calculations based on OECD and Eurostat data

Here we can observe several broad features that are characteristic for the entire region. First, apart from Slovenia, all Eastern European countries substantively reduced their corporate tax rates in the examined period; the only difference is in *how much* they reduced them – with cuts being particularly pronounced in the Southeast European countries, the Baltic states and Slovakia. Second, the 'size' of Eastern European states – measured in terms of state revenues as a percentage of GDP – is pretty stable over time, the only exception being Slovakia whose state drastically 'shrank' in the examined period. Third, the flexibility of their labour laws also appears rather stable over time – those with more flexible labour laws to start with, remain flexible; while those with more rigid labour laws remain rigid. The only exception is Slovenia, where there was a liberalisation of labour law in the examined period. Fourth, all of the countries already had extremely minimal out-of-work income protection in the 1990s, and this has not become any more generous ten years later - it actually even decreased in the Visegrad countries.

Still, they display rather different patterns of change. Slovenia decreased its levels of state aid and slightly reduced overall social spending, as well as revenues as a percentage of GDP, but its social policy did not become more productivist since relative spending on education and ALMP also decreased. It is also the only state that did not cut its corporate taxes. Hence, the reforms in Slovenia could be described as mild liberalization, rather than a transformation into a Competition State.

Bulgaria and Romania dramatically cut their corporate tax rates, reduced state aid, increased the share of VAT in revenues and, at the same time, made their social policy both more generous and more activist. Apart from unemployment benefits, they actually increased spending on all social items. This increased generosity, however, comes against the background of very minimalist welfare states to begin with so that they still maintain very meagre social spending.

The Baltics also radically cut corporate taxes, but they simultaneously increased horizontal aid to enterprises. On the social policy side, they reduced all items of social spending, but this did not represent an increase in the productivism of their social policy, since the share of ALMP in their labour market policy and the level of education as a proportion of total spending remained stable. It should be noted, however, that the Baltic states placed quite heavy emphasis on ALMP and education to begin with, so that their current spending priorities still maintain a productivist outlook.

Slovakia displays the most radical pattern of change, with a substantive decline of revenues as a percentage of GDP, a drop in corporate tax rates, an increase in state aid to enterprises, more flexibility added to the labour law and cuts in social spending items. Its overall social spending did become more productivist with rising share of education in total spending, but its labour market policy recorded the opposite trend with a fall in relative spending on ALMP.

As for the three Visegrad countries, the most important changes are recorded in horizontal aid to enterprises which substantively increased. At the same time, their social policy became both more generous and more activist, with rises in relative spending on ALMP and education coupled with a small rise in general social spending.

With respect to my initial expectation that Eastern European states would be more likely to develop into Competition States, the data show that most of them did adopt a more productivist social policy outlook (Southeast European countries, Slovakia and the Visegrad 3), or already had very high shares of education and ALMP in total spending (the Baltic states). However, it should be noted that this increased concern with recommodifying policies does not come about through a decrease of social spending, since in the case of the Visegrad 3, Bulgaria and Romania we actually witness a rise in social spending – although this rise does not come close to the average Western Continental generosity. As for the fiscal policy side, most of the countries both cut taxes and increased incentives but some have put much more emphasis on investment incentives, more than doubling them in 10 years, while the others have been less generous with state aid and have instead adopted the policy of radically low corporate taxes.

Bearing in mind the historical context of transnational capitalism and the parallel transformations apparent in the Western European states, it comes as no surprise that the 'Europeanization' of

Eastern Europe did not mean that these countries became similar to the generous and redistributive 'Golden Age' welfare states, as the Europeanization literature had expected. This is particularly interesting since in this period Eastern European countries were actually recording impressive economic growth – however, this growth did not translate into high social spending, redistributive fiscal systems or the development of policies that would strengthen labour's bargaining power vis-à-vis capital. Some of the features of their models in the 1990s could indeed be attributed to their lower level of economic development – for instance, having a high share of VAT in total revenues is typical for developing countries, and the same goes for lower social expenditure, smaller states or undeveloped unemployment compensation systems. However, neither the economic growth that these countries experienced in the examined period nor the impact of the European Union caused them to converge on the policy models that characterised the rich, industrialized countries in the 20th century. To the contrary, economic growth was actually accompanied by the *increase* of their reliance on consumption taxes as a source of state revenues as well as a drop in corporate tax rates. Thus, despite the fact that in this period Eastern European countries were busy with the intensive 'harmonization' of their institutions with the EU regulation, the result of this 'Europeanization' seems to be very far from the Continental or Scandinavian European models as we know them from the 1990s.

Nor does their evolution over time mean that they have simply become more liberal – in the sense of decreased state revenues for instance, or cuts in *all* social policy items or all kinds of state expenditure. Instead, some of these countries actually experienced a rise in their social expenditure – however, at the same time they further increased the share of their total spending going to ALMP and education. Hence, even in cases of increased generosity, their social policy reforms certainly did not represent attempts at strengthening decommodification, but rather they constituted a recommodification of their labour force. This actually puts their reforms apart from those of the European South – since Mediterranean countries, although becoming more generous, did not simultaneously adopt more productivist social policies. Interestingly enough, in the Mediterranean the decreased emphasis on human capital and less extensive investment incentives countries seem to have repercussions for their industrial development, since Visegrad countries (at least when it comes to automotive industry) recorded much higher industrial upgrading and faster progress in climbing up the value-added-production chain than the Southern periphery (Scepanovic, 2009). Coupled with quite radical fiscal reforms in the East (cuts in corporate taxes, or the introduction of very generous investment subsidies) this means that the broad trends in the new member states could indeed be described as the emergence of

Competition States rather than either the development of Gold Age welfare states, or the simplistic process of 'state shrinkage'.

Third, despite the common process of economic transnationalisation and integration with the EU that took place in all of these countries in the examined period, these processes actually resulted in increased differentiation among Eastern European states, rather than their convergence. Two models emerge: the low-tax, low-aid, low-social expenditure model coupled with relatively more rigid labour laws and the medium-tax, high-aid, medium-social-expenditure model coupled with very flexible labour laws. The exception to this pattern is Slovakia which is marked by low-tax, medium-aid, low expenditure and flexible labour laws. The first group – low-road Competition States – actually resembles the Irish model of attracting FDI through remarkably low tax rates, while the second one – high-road Competition States – is based more on attracting investment through generous subsidies and is more similar to the Swedish and Danish path. (An analysis that focuses less on welfare state dimensions and excludes pensions, family benefits and social exclusion spending would indeed result in grouping the Czech Republic, Poland, Hungary, Sweden and Denmark in a single cluster. However, due to the large differences in their welfare state generosity, in the more comprehensive analysis they are placed in different clusters.)

Discussion

The analysis shows that European states, both Eastern and Western, display not only divergent policy models at a specific point in time, but also divergent patterns of transformation. The table below summarizes the positioning of countries in 1995 and 2007.

Table 10. Cluster membership in Europe 1995-2007

		2007				
		Eurozone cluster	**Netherlands**	**New Scandinavian**	**High-road Competition State**	**Low-road Competition State**
	Continental	Austria Belgium Finland France Germany	Netherlands	Sweden Denmark		
1995	**South 1**	Portugal Spain				Bulgaria Romania
	South 2	Italy Slovenia			Poland	
	Liberal				Czech R. Hungary UK	Ireland Slovakia
	Baltic					Estonia Latvia Lithuania

The convergence of the Eurozone comes about primarily through the convergence of Mediterranean fiscal policies with the Northern ones, with cuts in the Southern levels of state aid as well as in corporate taxes. On the social side, however, the convergence is a result of both the increased generosity in the Southern countries – with respect to social exclusion and family benefits – and the cuts and increased recommodification apparent in the Northern countries. However, contrary to the expectations that monetary union will push countries further in the direction of increasing competitiveness, the Eurozone convergence did not result in policy mixes that would resemble ideal-type Competition States – indeed, other than labour law liberalization, Southern European states have typically implemented reforms that would go in the direction *opposite* of increasing competitiveness. With respect to the debate on European integration, and in particular the view of the monetary union as yet another factor pushing towards the Competition State model, it is thus interesting to note that, with the exception of Ireland, such a transformation is actually primarily a feature of countries that remained *outside* of the Eurozone, while the Eurozone members were less likely to undertake competitiveness-oriented reforms. Other than the Netherlands, which has developed a specific balanced 'competitive corporatist' model, all other Eurozone states have in fact seen their policies converge since the creation of the common currency and these policies are further away from any kind of Competition State ideal-types than those of the euro-outsiders. Given the expectations that the EMU would push countries into implementing measures that increase their competitiveness, this finding is certainly puzzling. However, those expectations are based on the idea that increased market integration creates pressure to increase competitiveness, ignoring the fact that competitiveness becomes somewhat an elusive concept in the context of monetary union as any current account deficits run by individual countries no longer influence the exchange rate. Hence, with the creation of the monetary union, export competitiveness should actually become *less* rather than more important. Furthermore, as argued by Boyer (2000b), the integration of financial markets has already rendered 'Keynesianism in one nation' an impossible strategy and has basically excluded the possibility of adjustment through exchange rate setting policies. In that context, the only consequence of the creation of the Eurozone would be deeper market integration and stronger pressure for firms and states to adjust to the needs of the common market as otherwise they would face economic losses. With the benefit of hindsight, however, it is clear that this development was ameliorated by the rise of private debt in the peripheral countries - similar to the concept in Crouch (2009) of Privatized Keynesianism in the UK and USA - as well as by the real-estate and construction bubbles, all associated with the low interest rates experienced since entering the Eurozone. Hence, rather than accentuating the pressure to implement competitiveness-enhancing measures, the creation of the Eurozone actually relieved some of the pressure to do so in the periphery. However, the results show that Eurozone also acted as a buffer for the core countries. There, the introduction of Euro initially brought them a competitive advantage since they joined it from the position of hard currencies while the Euro itself initially experienced a devaluation against the US Dollar (Crouch, 2001). This initial advantage, added to the fact that they were now even more integrated with the peripheral countries that were at the same time experiencing the rise of private debt (and consequently rising domestic demand), meant that the core countries were also under less pressure to increase competitiveness. In other words, inside the Eurozone there seems to have been less pressure overall to introduce competitiveness-oriented policies as peripheral countries relied on privatized Keynesianism, and core countries relied on the increased demand from the periphery as a source of maintaining their growth. Thus, rather than acting as a catalyst for widespread transformations into Competition States, the creation of the Eurozone really acted as a buffer reducing any pressure on individual countries to develop into Competition States.

The countries outside of the Euro did, however, still have to face pressures from financial markets urging them to adopt competitiveness-oriented policies – and this is precisely what they did. They are all small export-oriented economies and, more importantly, they all have national currencies meaning that it is much more difficult for them to sustain large current account deficits than it is for the countries in the Eurozone. Outside of the shield of the Euro, they were thus much more exposed to the pressures of the global markets. Still, the reforms that they implemented are far from being uniform, and two types of strategies can be distinguished: the high-road one and the low-road one. Given the different starting positions of these states, this has led to the emergence of three different models of Competition States: New Scandinavian, high-road Eastern Competition States (or Porterian, in Drahokoupil's terminology) and low-road Eastern Competition States or minimalist states.

As elaborated above, the two Scandinavian non-Eurozone members have indeed experienced deep reforms that set them apart from the Continental European countries to which they were quite similar in 1995. Scandinavian welfare state changes, in particular those in Sweden, have received a lot of academic and policy attention – and the predominant view seems to be that the Swedish case represents an example of the 'updated' or 'modernized' Social Democratic model, which nevertheless remains faithful to the basic tenets of Social Democracy (Steinmo, 2010). In these interpretations, the adding of flexibility to labour laws, the restoration of wage coordination after its complete breakdown in the 1990s, as well as the increased activism and supply-side orientation of labour market policies are all seen as a return to the basic premises of the famous Rehn-Meidner model and the restoration of the original Social Democratic policies. Meanwhile, the changes introduced in the 1970s (more protective labour laws, more demand-side oriented ALMP, currency devaluations, etc.) are presented as deviations from the Rehn-Meidner approach. Nevertheless, I believe that this interpretation does not do justice to the depth and qualitative nature of the changes made in contemporary Swedish political economy compared with the traditional Social Democratic model. Namely, the revival of wage coordination did not represent the return to centralized wage bargaining, but rather sectoral level bargaining. Although not included in my cluster analysis, this aspect is very important since it represents a fundamental shift from the Rehn-Meidner model in which centralized bargaining and the principle of 'equal pay for equal work' were key instruments for enabling structural change in the economy as firms and sectors that were not able to pay relatively high wages were assumed to be squeezed out of the market. The abandonment of centralized bargaining means that, in the new Scandinavian model, low-wage sectors are allowed to persist – studies indeed record increased inter-firm wage dispersion in Sweden after the breakdown of centralized bargaining (Hibbs and Locking, 2000) - and capital can no longer be assumed to flow from less productive to more productive sectors. More recent fiscal reforms, and the introduction of in-work tax credit (adopted in Sweden in 2007 and in Denmark in 2004) similar to the tax credits existing in USA and UK, further reinforce the new tolerance or even active subsidization of low-wage sectors in these two countries. This, in turn, has important implications for the character and role of both active labour market policy and flexible labour laws. More precisely, while in the Rehn-Meidner model ALMPs and labour law flexibility were supposed to assist workers' transitions in the process of sectoral change from less- to more-productive sectors, when the key instrument for achieving this sectoral change is taken out of the system these policies act primarily as an instrument for including low-wage workers and enabling firms to make use of temporary workers. Studies indeed show that, from the 1990s onwards, active labour market policies shift from demand-side to supply-side measures but, contrary to the revival-of-Social-Democracy-thesis, the emphasis is not on vocational training but rather on employment assistance and strengthening the incentives to take up jobs. Furthermore, while previously participation in active measures made individuals eligible for regaining unemployment insurance in both Sweden and Denmark, this was no longer the case after the reforms in the 1990s (Bonoli, 2010).

With respect to labour law flexibility, liberalization in Sweden and Denmark has also largely amounted to the liberalization of the use of temporary workers – hence, not exactly corresponding to the Rehn-Meidner-ist idea of workers' flow from less- to more-productive sectors. Thus, contrary to the interpretations prevalent both in academic as well as in policy circles, I would argue that the new activism and flexibility of Swedish and Danish labour market polices do not represent a simple return to the traditional Social Democratic model. On the contrary, I believe that we are actually witnessing an example of institutional change that Streeck and Thelen (2005) would call conversion, and that ALMPs and flexible labour laws that were once part of the traditional Social Democratic model are redeployed for different purposes in the new constellation. A useful counterexample in this case is Finland, where centralized bargaining was indeed preserved until 2007 and which did not follow the same path as the two other Scandinavian countries. Compared to its Scandinavian counterparts, Finland has lower share of ALMP in total labour market policy, it implemented less radical spending cuts in unemployment benefits, while its liberalization of labour law primarily tackled regular workers as opposed to Swedish and Danish reforms that liberalized the regulation of temporary work. Hence, in comparison with Finland, or indeed with their own policies in the mid-1990s, Sweden and Denmark have departed greatly from their original model based on a social compromise that accommodated the demands of both capital and labour. Although some of their policies share the same name, and command the same (or perhaps even higher) prestige, as they did in the heyday of the Rehn-Meidner model, their function in the changed system actually makes them much more similar to liberal workfare, rather than traditional Social Democratic policies. Interestingly enough, the split in the clustering of Scandinavian countries exactly corresponds to the membership in the Eurozone, with Finland joining in 1999, while Sweden and Denmark maintained their national currencies. The Scandinavian pattern thus shows that Eurozone membership clearly matters and that the countries outside of the common currency are indeed more likely to turn into Competition States. However, the direction taken by the Swedish and Danish reforms indicates that they have embarked on a high-road transformation seeking quality-based competitiveness, with notable increases in state aid for investments and even more pronounced human capital and activation spending than before – rather than cutting taxes and all items of social spending to the same extent.

Similar to the above cases, the Czech Republic, Hungary and Poland also pursued the high-road type of transformation. They certainly do not develop generous welfare states that could compare with the Western Continental or Scandinavian models, but they do combine recommodification with a small *increase* in social spending. Similarly, their fiscal policy recorded changes similar to those of the Scandinavian model, with the roll-out of very generous FDI incentive schemes, but without reducing the total share of tax revenue in GDP.

Contrastingly, in Slovakia, the Southeast states and the Baltic countries drastic cuts were implemented in corporate tax rates without increasing state aid, with Slovakia sharply reducing the share of state revenue in GDP and the other states being, in European terms, very small to begin with. Furthermore, their path of radical social recommodification was achieved primarily through cuts in social spending. This pattern of transformation thus corresponds to the low-road transformation and results in the emergence of Minimalist Competition States.

The analysis thus shows that there is no such thing as a unique Competition State ideal-type, but instead there is a variety of them. Furthermore, the states that do show both Schumpeterian and workfare features actually display patterned combinations of different *kinds* of pro-enteprise policies alongside different types of recommodifying social policies, with generous investment incentives being coupled with more generous workfare policies, and low taxes across the board appearing together with very 'lean' workfare provisions. These combinations thus reveal some different strategies for increasing competitiveness which, in line with the discussion in the previous chapter, could be identified as quality-based and cost-based strategies respectively.

At this point, we are faced with the question of how to explain the observed divergence outside the Eurozone. The first observation is that it obviously results both from the initial institutional set-up as well as from the strategy implemented, i.e. the high- or low-road. The New Scandinavian model, despite its departure from the premises of the Rehn-Meidner model, is still far from the Minimalist or the Porterian Competition States witnessed in the East of Europe – which seem to be much closer to the liberal Western states. Therefore, the historical legacy of their Social Democratic welfare state institutions obviously matters for the end-result obtained in Sweden and Denmark. However, the choice of the strategy pursued cannot simply be explained by the institutional legacies of the Social Democratic welfare state model, since the same strategy is apparent in countries with rather different institutional backgrounds – namely, the Czech Republic, Hungary and Poland.

The Eastern part of Europe has indeed witnessed a very interesting dynamic, with increased divergence over time and with *both* of the strategies for increasing competitiveness being implemented by different countries. The developments in this region could thus provide some interesting insights as to the reasons behind the adoption of different Competition State strategies. It should be noted that an increased divergence is also apparent among Western Liberal states with the UK and Ireland splitting into two different clusters; however, as the initial analysis shows, this split appears only after the East European states are included in the analysis so it should be treated with caution. East European divergence, on the other hand, is a rather clear finding and is also confirmed by other studies of the region – so it is thus perhaps the best entry point for exploring different models of Competition States.

The grouping of the countries already suggests that certain potential explanations for this divergence should be ruled out. To begin with, the clusters of states appear similar, but not identical to the countries grouped in the neo-Polanyian varieties of transnational capitalism approach (Bohle and Greskovits, 2012). Slovakia clearly departs from its Visegrad group and appears more similar to the Baltic and Balkan states. Somewhat similar to the neo-Polanyian approach, a classification dividing the cases into semi-core and semi-periphery countries on the basis of the export-structures in the region (Bruszt and Greskovits, 2009) does not correspond to the clusters found here either. The same can be said for the classification of the economic growth models in the East which distinguishes between dependent industrialization and dependent financialization (Becker and Jaeger, 2010). For all of these classifications, Slovakia's placement in the minimalist model is puzzling. Economic structures thus seem unable to explain the pattern observed.

The historical legacies of East European social and welfare institutions seem even less credible as explanatory factors, especially the legacies of socialist welfare institutions. Firstly, and somewhat surprisingly, East European states overall appear so close to the Western liberal models that there is nothing particularly socialist in the outlook of their state policies. Secondly, even the states that had the same type of socialist institutions and, moreover, had similar institutions during the phase of early capitalism (i.e. mid-1990s) display increased divergence over time. Historical legacies, in the sense of socialist or early capitalist welfare or fiscal institutions, thus probably do not represent a likely explanation for developments over time.

This leads us to the third potential explanation – namely, political agency. As argued in the previous chapter, the choice of which strategy for increasing competitiveness a country implements will depend on certain features of the domestic political system which can act as a 'beneficial constraint' pushing towards quality rather than cost-based competitiveness. More specifically, it will depend on the prevalence of the socio-economic cleavage as the basis for political party competition. Although scholarship on Western welfare states and their economic strategies has tended to focus primarily on the strength of trade unions and the left parties, the strength of the left political parties actually appears relevant only to the extent that the competition among political parties indeed *is* based on a differentiation between the socio-economic left and right. The scant attention paid to the existence or absence of a socio-economic cleavage as a precondition for the power-resource of labour in studies of Western politics is perfectly justifiable given the fact that in almost all Western democracies, with the exception of Ireland, it has either been the single most dominant cleavage or one of the two most important dividing factors. However, once the analysis includes both Western and much younger Eastern democracies which developed in a different historical context, and where the structuring of party systems often followed a different logic, the dominance of the socio-economic cleavage can no longer be taken for granted.

The results of the cluster analysis indeed suggest that the structure of the political party system *should* matter, since Minimalist or Low-road Competition States – which are in many respects the embodiment of clear neoliberal blueprints – seem to be more typical of countries which have experienced difficulties in the process of their democratization either due to the predominance of ethnic politics in the Baltics or due to the prolonged semi-authoritarianism in Slovakia, Bulgaria and Romania; the difficulties which have moved their politics away from the socio-economic left-right issues. The only Western country included in the Minimalist Competition State cluster is Ireland: a state where the socio-economic cleavage is traditionally weak due to the predominance of national independence issues as the historical basis for structuring party competition. Thus, political developments – and in particular the way in which the structure of the party system represents the political power-resource of labour - rather than a county's geography, economic structures or initial welfare state institutions seem to be the best candidate for explaining the divergence among Competition States.

Conclusion

Several conclusions can be reached from the above analysis. First, with respect to the question of whether empirically there is such a thing as a Competition State that would combine all of the features assumed by the theory (low corporate taxes, high investment incentives, low income protection, high human capital spending, flexible labour laws), it turns out that none of the European states approach this ideal type. However, once the assumptions of the theory are slightly relaxed and the existence of *different types* of Competition States is allowed for – a move that seems justified by analogy to the different types of competition seen in product markets – there indeed are states in Europe that have experienced both economic and social policy reforms going in the direction of increasing competitiveness and which thus can be considered representatives of different kinds of Competition States. These would be the Scandinavian Competition States; the Porterian Competition States in the Visegrad region and the Minimalist Competition States in the Baltic region, Southeast Europe and Ireland.

Whether a state transforms into a Competition State or not indeed seems to be the result of the pressures of the transnational economy and, more precisely, international financial markets – since state transformation is primarily a feature of those states which have retained their national currencies, rather than those which are part of the supranational monetary union. The presence or absence of state transformation is thus *not* a matter of national politics strictly speaking, but is rather an outcome of supranational political responses such as the EMU (of course, creating the EMU or joining it is itself the result of political decision but the politics of monetary integration is beyond the scope of the current thesis). In that sense, the structural pressures of economic transnationalisation, acting in particular through the operations of the international financial markets, do appear real and are perhaps more important for the convergence or divergence of European state policies than the comparative political economy would have us believe. The relative stability of the Continental state policies or the counter-competitiveness-movements of the Southern European states turns out to be much more a result of those countries' Eurozone membership than of their particular national politics, varieties of capitalism, models of welfare state or any other national-level source of variation.

Yet, while the pressures to transform indeed *are* real and particularly tangible for states that maintained one of the key prerogatives of state sovereignty – namely national currencies – the transformation itself can still be undertaken via two different routes. In line with the earlier proposed distinction between quality-based and price-based competitiveness, these two routes are here labelled the high-road and the low-road. The choice of route, however, does *not* seem to be the result of a direct translation of structural pressures nor simply a functional response to the particular mode of capitalist growth because we have seen that countries with rather similar growth models and similar profiles of insertion in global markets – such as Czech Republic and Slovakia – have actually followed rather different paths and ended up with different state models. Thus, it is proposed here that the type of state transformation and the strategy used for increasing competitiveness are the result of a political process rather than simply the result of economic structures or pre-existing national welfare institutions. In order to explore this hypothesis, and to examine *how* the political process can shape states' transformations, the second part of the research will focus more specifically on the study of Czech Republic and Slovakia. These two cases represent different types of Competition States, and thereby serve to highlight the mechanisms through which domestic politics and the workings of national political systems play a role in the emergence of Competition States.

PARTY POLITICS AND COMPETITIVENESS STRATEGIES – EXPLAINING THE DIVERSITY OF COMPETITION STATES

Introduction

While in the previous chapters I have argued and empirically demonstrated that Competition States come in different guises and that two different strategies of increasing competitiveness can be distinguished in Europe, in the second part of the thesis I focus on explaining the reasons for these different pathways of state transformation. In order to do that, the second part of the thesis provides a comparative study of state transformations in the cases of two different types of Competition States – a high-road strategy in the Czech Republic and the low-road option in Slovakia. The main argument put forward in this part of the research is that the choice of strategy for increasing competitiveness will depend on the features of the political system and, more precisely, on the dominance of a socio-economic cleavage as the basis for competition between political parties in the national party system.

Before turning to the analysis of state transformations in the Czech Republic and Slovakia, in this chapter I will first elaborate on the basis of the case selection as well as the explanatory framework used to explain the increased divergence of these two states. The argument that it is the domestic political party system that shapes the adoption of different strategies for increasing competitiveness will be contrasted with other explanations found in the literature on different state strategies in global economy, as well as the explanations developed especially for the divergence of Eastern European political economies. The relation between the party system and competitiveness strategies will then be further elaborated in the final section of this chapter and will be demonstrated in the case-studies of Czech Republic and Slovakia in the subsequent chapters.

Case selection

The Czech Republic and Slovakia are taken here as cases of two different types of Competition States, the Czech Republic exemplifying the high-road Competition State, and Slovakia the low road variant. In terms of their policies and strategies for increasing competitiveness and attracting FDI they appear markedly different, and these differences are apparent not only in the variables examined in the statistical analysis in the previous chapter (most notably, in welfare spending, investment incentives and tax policies, but also in education spending), but can also be seen in other dimensions that are often associated with the strategies for increasing competitiveness. As already argued in the previous chapter, infrastructure provision and R&D policies were not included in the statistical analysis since the analysis was focused primarily on the direct support to private investment so that the usual measures of public investment for infrastructure and R&D would not be optimal from the perspective of content validity. However, if for the purpose of highlighting in more details Czech and Slovak strategies for increasing competitiveness, we use proxies for infrastructure provision and R&D policies, the two states again appear markedly different. For instance, Czech public investment in infrastructure, proxied as government gross capital formation, equals 4.1% of GDP in 2007, while in Slovakia it is only 2% of GDP (source: Eurostat). Similarly, research and development intensity which should also be the mark of the high-road Competition States as opposed to low-road ones is also twice higher in the Czech Republic than in Slovakia, with government spending on R&D increasing from 0.24% of GDP in 1995 to 0.31% of GDP in 2007 in the Czech Republic and falling from 0.37% of GDP in 1995 to 0.16% of GDP in 2007 in Slovakia. The difference is even more pronounced with respect to R&D spending in the business sector which in the Czech Republic rose from 0.59% of GDP in 1995 to 0.92% of GDP in 2007, while in Slovakia it fell from 0.5% of GDP in 1995 to 0.18% of GDP in 2007 (source: Eurostat). Although not included in the cluster analysis in the previous chapter, the above variables still confirm the findings of the statistical analysis and point to profound differences in the strategies for increasing competitiveness implemented by the Czech Republic and Slovakia.

Other than their different form of state transformations, these two states however share a number of other important features, which make them ideal cases for the most similar case design. They are both small, export-oriented, foreign investment based economies that shifted from internally-oriented strategies of national capitalism and welfare state building in the 1990s to actively fostering economic transnationalisation in the late 1990s/early 2000s. They also share important economic, political and institutional legacies, having been part of the same state for almost a century, so that their divergence represents almost a natural experiment. Furthermore, after gaining national independence in 1993, they both initially attempted to build national capitalism and only in the late 1990s turned towards outward-oriented strategies of attracting FDI and increasing competitiveness. In this period they also both experienced the same type of economic transnationalisation, with predominantly manufacturing FDI and similar complex-goods based structures of exports. Both countries maintained their national currencies up until 2009, thus being equally exposed to the pressures of the international financial markets and being more vulnerable to currency crises associated with rising current account deficits – which made them more prone to transform into Competition States in the first place. Thus they represent almost ideal cases for the most similar case design.

Approaches focusing on globalization as an equalizing force leaving little space for independent policy choices would naturally expect the convergence of their state policies. This has indeed been argued by Drahokoupil (2009) who sees them both as cases of Porterian Competition States as well as Appel (2011) who examines in detail the fiscal race to the bottom in Eastern Europe. Similarly, there are studies of Czech and Slovak political economies as cases of Polanyian embedded neoliberal capitalism (Bohle and Greskovits, 2012) or of VoC-inspired Dependent Market Economies (Nolke and Vliegenthart, 2009) which also suggest that the two countries should have a broadly similar policy outlook. Bohle and Greskovits consider the two rather closely matched in the ways in which they have balanced market liberalization and social protection, having both started off with a welfarist social contract that subsequently came to be replaced by efforts to actively embed transnational corporations in the national economy. Nolke and Vliegenthart, on the other hand, define them both as cases of Dependent Market Economies – and since one of the implications of the VoC approach, with their idea of institutional complementarity, is that market actors will themselves seek to preserve institutions that bring them a comparative advantage, the expectation would be that DMEs should also record similar policy developments. On the other hand, broader political economy theories which see state size as the determinant of strategies in the world economy (Katzenstein, 1985), or the economic theories which take the stage of development as the determinant of strategy for increasing competitiveness (Porter et. al., 2008) would also expect that their strategies would be largely the same as they are both small states and with very similar positions in the global division of labour. The same goes for those theories that focus on historical institutional legacies – in particular the legacies of socialist welfare states (Inglot, 2008; Cerami, 2006; Haggard and Kaufmann, 2008), or indeed the legacies of the 'emergency welfare state' (Inglot, 2009: 73) established immediately after the collapse of socialism which, for these two states, occurred within the framework of the unified Czechoslovak Federation. For all of these approaches, the divergence of Czech Republic and Slovakia represents a puzzle – and it is the argument of this thesis that this puzzle should be resolved by the reference to different political developments and different party systems developed in these countries.

It should also be emphasized that, in contrast with the majority of the literature analysing Czech and Slovak political economies, the thesis does not take Czech Republic and Slovakia as cases of two different post-socialist developments by *a priori* looking at them through the prism of post-socialism. Indeed, the results of the statistical analysis suggest that post-socialism is not the most relevant variable shaping the boundaries among states in contemporary Europe – Slovenia is easily classified as a Western European small corporatist state, while Ireland is as radically neoliberal as the post-Soviet Baltic republics. Rather than focusing on the differences in *post-socialist* reforms undertaken by Czech Republic and Slovakia, the thesis focuses on the differences in their externally oriented strategies developed in the late 1990s, thus finding a shared starting point not in their similarity during socialism, but rather in the similarity of their state forms in the period of national capitalism in the 1990s. In other words, the thesis compares Czech Republic and Slovakia not as two socialist states developing different types of capitalism, but rather as two capitalist states developing different externally-oriented strategies. The shared economic legacy of socialism thus does not really influence their subsequent divergent developments; to the contrary, their post-socialist character appears only to the extent that the development of their political and party systems represent examples of different approaches to resolving the dilemmas of simultaneous economic and political transitions.

Nevertheless, by taking Czech Republic and Slovakia as the case studies, the thesis certainly addresses the main debates and contributions made in the political economy studies of Eastern Europe. The next section will thus briefly review the main arguments made in this literature, after which I will turn to the more detailed elaboration of the party systems argument proposed here.

Political economy of East European divergence

Political economy explanations of policy divergence in Eastern Europe constitute a rather dispersed field. The lion's share of the literature focuses mainly on more narrow policy areas - either welfare states examined through a broad outlook of social policies, or even single policy areas like pensions, labour market institutions, or fiscal policy. Furthermore, comparative studies tend to focus on individual countries, rather than groups of countries. Notable exceptions are Bohle and Greskovits (2012); Bruszt and Greskovits (2009), and Nolke and Vliegenthart (2009) that all focus on *types* rather than individual nation-states. However, the latter studies take both state policies and economic structures as the basis of their typology – thus assuming rather than questioning or assessing the correspondence between state policies (or combinations of state policies), on the one hand, and economic structures or patterns of socio-economic developments such as the profile of global insertion or the form of economic dependency, on the other. In contrast to the latter approaches, the present thesis focuses only on state policies, leaving open the question as to whether the differences in state actions indeed bear consequences in the form of different patterns of economic development or different modes of transnationalisation.

The literature has also proposed different hypotheses on the developments in East European political economies, including their economic and social policy reforms. Some such studies have focused more on the influence of external factors – either structural constraints of global capitalism (Drahokoupil, 2009; Appel, 2011) or the agency of transnational actors, in particular international financial institutions (Muller, 2003; Orenstein, 2009) and the EU (Vachudova, 2005). Others have, instead, zoned in more on certain internal factors – the relevance of historical legacies, in particular institutional legacies (Inlot, 2008; Cerami, 2006; Haggard and Kaufmann, 2008) and domestic political actors (Vanhuyssee, 2006; Guardiancich, 2009; Keune, 2006). With regards to the former, it will be demonstrated that external constraints, while being an important element in triggering state transformation, do not fully explain the *direction* of strategies and policy reforms undertaken. Both the Czech Republic and Slovakia found themselves in economic crisis due to their high current account deficits and both of their currencies were under the attack of the international financial markets. While both of their inwardly-oriented strategies of building national capitalism in the 1990s thus failed due to a combination of internal weakness and an external environment unwilling to tolerate these weaknesses, the responses to such crises and the direction these states took after their crises cannot be accounted for only by reference to the structural constraints of transnational capitalism because the latter were, by and large, the same in these two states.

The role of international actors, on the other hand, also fails to properly explain the divergent developments of the Czech and Slovak pathways since both of these states inherited low state debt from the socialist period and, thus, were not being forced to shape their policies in line with the requirements and the conditionality of the international financial institutions. To the extent that their advice was sought, it was actually largely at the invitation and the initiative of domestic political actors, rather than being the result of the external imposition and conditionality of the IFIs. As for the domestic historical institutional legacies, these are again unable to account for the divergent developments of two countries with as much shared history as the Czech Republic and Slovakia. As regards the domestic political actors, a prominent approach in the literature has been to examine the effects of neocorporatist institutions and the strength of trade unions. However, trade unions in both the Czech Republic and Slovakia have had a fairly weak role in policy making (especially compared to the trade unions in Slovenia) and their influence has been conditioned primarily by an alliance with, and the incumbency of, the leftist political party – which brings us again back to the parties and party systems arguments.

Among the studies of patterned divergence in the East – i.e. focusing on groups rather than individual countries - probably the most prominent account has been offered by Bohle and Greskovits (2012) with their differentiation between embedded neoliberal, neoliberal, and neocorporatist varieties of East European capitalism and their argument deserves a more extended elaboration here. In their study of the varieties of capitalism in Eastern Europe, Bohle and Greskovits propose two major explanations for the differences among embedded neoliberal capitalisms with their more generous welfare states and generous subsidies to TNCs, on the one hand, and purely neoliberal capitalisms with small, low-tax and low-spending states, on the other. The first explanation pertains to the 'opportunity structures for legitimation and contestation' (Bohle and Greskovits, 2012: 82) – i.e. the predominance of idealistic or materialistic politics during the 1990s, which is the main reason for the difference among the neoliberal Baltic countries and the embedded neoliberal Visegrad states. While in the Baltic republics, the 1990s were a period with predominantly idealistic politics focused on ethnic and nation-state building issues, in the Visegrad countries the initial years of the transformation saw largely materialistic politics, with relatively generous welfare states established as a means of compensating for the social dislocation caused by the economic transformation. Another explanation is offered for the increased divergence among the Visegrad countries and the neoliberal Southeast European states of Bulgaria and Romania. Here the crucial element is not the differentiation between materialistic and idealistic politics, but a contrast in levels of state capacity whereby the weak state capacity in the Southeast is seen as having led these states to adopt neoliberal models. The latter are assumed to require less administrative capacity – for instance with respect to tax collection – while state weakness also contributed to the larger role assumed by the international financial organizations, primarily the IMF, in advocating radical neoliberal reforms such as currency boards and flat-taxes in the Southeast European counties. Although Bohle and Greskovits would classify Slovakia as a case of embedded neoliberal *capitalism* (while acknowledging the presence of certain policy reforms that make it more neoliberal than the rest of the Visegrad group), my exclusive focus on *states* as well as the different methodology employed result in the Slovak state being placed in the neoliberal, or low-road Competition State, cluster together with the representatives of Bohle and Greskovits' neoliberal capitalism. The question is, however, how well the hypotheses proposed by these authors fit the Slovakian case and if they help explain the increased divergence between the Czech Republic and Slovakia. To start with the state weakness hypothesis, it is true that the Slovak state could be described as a captured, and hence weak, state in the 1990s. However, by the time it actually shifted towards a low-road Competition State approach in the early 2000s, its state capacity had substantively improved. According to the quality of governance indicators as a proxy for state capacity in Bruszt and Greskovits (2009), Slovakia certainly scores higher than Bulgaria and Romania (64.57 as opposed to 52.22 and 50.37 respectively) and is actually very close to the score of the Czech Republic (65.61). Furthermore, as opposed to Bulgaria and Romania, neoliberal reforms in Slovakia were not implemented following pressure from international financial organizations – rather, they were the result of the implementation of home-made agenda of local neoliberals. Hence, state weakness does not seem to be a likely candidate for explaining the divergence of the Slovak and Czech paths.

The distinction between predominantly idealistic and predominantly materialistic politics turns out to be potentially more relevant. However, while employing the conceptualization of 'opportunity structures for legitimation and contestation' that captures the *content* of politics and the focus of political struggles in a given political system, Bohle and Greskovits still do not link their differentiation directly with party politics and the development of party systems when explaining the divergence in the 1990s or 2000s. Only when they turn to the discussion of the economic crisis of 2008-2009 do they argue that the ethnicization of politics in the Baltic republics resulted in a party system which is not conducive to producing alternative and competing economic strategies for resolving the crisis and, then, this characteristic of party systems is invoked as an explanation for the radical austerity measures adopted in the Baltic states (Bohle and Greskovits, 2012: 235). The line of argumentation pursued here, however, takes the distinction between predominantly materialistic and predominantly idealistic politics but links it more directly with the political systems theory which, in its classical elaboration by Easton (1957) and application to the East European transformations by Offe (1991), distinguishes three different sources of legitimation and the three concomitant levels of politics: identity issues, procedural issues and redistributive issues. While the opportunity structure for legitimation and contestation pertaining to materialistic politics corresponds to the third level of legitimation-producing politics centered on socio-economic left-right issues, the first two levels of legitimation – i.e. identity and procedural issue-divides – would both match up to the idealistic politics in Bohle and Greskovits' framework. Elster et. al. (1998) indeed propose to conceptualize the political cleavages in the East European party systems precisely on the basis of these three types of divides: socio-economic, political-ideological and identity cleavage. Hence, what Bohle and Greskovits call an 'opportunity structure for legitimation and contestation' (Bohle and Greskovits, 2012: 82) is in turn taken to fundamentally shape political party systems, leading to party systems whose main axis of competition can be either an ethnicity and nation issue divide, as was the case with Baltic politics, or political procedures and institutional accountability issue divide, as was seen in Slovakia in the late 1990s (Deegan-Krause, 2006) – with both of these producing predominantly idealistic politics. Alternatively, the structure of legitimation corresponding to materialist politics is likely to produce party systems focused on socio-economic left-right issue divides, as occurred throughout the democratization period in the Czech Republic. The argument here is that the latter are much more likely than the former to produce political programs that will be differentiated primarily with regards to different economic strategies – which in the particular context of the shift from national to transnational capitalism also means that they will be likely to produce different strategies for managing transnationalisation, including not only the minimalist neoliberal but also the activist of high-road Competition State agenda.

The thesis that the characteristics of party system influence the likelihood of radical neoliberal reforms in the context of East European countries has already been proposed by O'Dwyer and Kovalcik (2007), who argue that the so called 'second generation reforms' are more likely in weakly institutionalized party systems. The main explanatory variable they employed was thus the institutionalization of party systems rather than the content of politics, or the axis of political competition. However, their specification of neoliberal reforms – or, as the authors refer to them, 'second generation reforms' - was not very precise, since the authors included investment incentives and low taxes along with low social spending among 'second generation reforms' – thus making the same mistake that the Competition State theory makes and presenting as a single bundle policies that actually belong to rather different political programs and that were empirically adopted by different countries. Consequently, for O'Dwyer and Kovalcik, a strongly institutionalized party system acts primarily as a *barrier* to reforms, while the exact content of the reforms is assumed to be given by the structural need of competition for capital. In other words, in their account politics only kicks in when it comes to preventing this 'natural' response to take place. The argument here is, to the contrary, that 'second generation reforms' do not represent a uniform set of reforms, but rather appear in different but patterned combinations constituting rather different political and economic programs. Hence, rather than seeing a neoliberal, minimalist agenda as the 'natural' response of small states to the pressures of the global markets, this thesis seeks to explore the politics of different responses to these pressures. Put differently, the focus is on the political conditions under which the minimalist-state neoliberal agenda indeed appears as a solution to which there is simply no alternative, as well as on the conditions under which neoliberalism instead emerges as but *one among several* different proposals and strategies for manoeuvring the domestic economy in the context of transnational markets. The question is, thus, not framed only as one of explaining the politics of the *failure* of neoliberalism, but rather as one exploring the political foundations of its success, or, in Streeck's words, the focus is not on politics against markets, but rather on different forms of politics with and within markets (Streeck, 1999: 7). Still, contrary to Varieties of Capitalism approach, this politics-with-markets turns out not to be determined by the characteristics of market actors, with their different sectors or specialisations, but rather by the different power constellations of *political* actors that have different ideas about the exact form that this market-conducive policy should take. In the next section, I will elaborate more how exactly this politics of competitiveness plays out.

Party systems and the politics of state transformation

In order to unpack the politics of the Competition State, it first has to be noted that the two relevant strategies for increasing competitiveness are based on different economic theories, which have quite different distributive consequences and which assume a rather different role for the state in the process of increasing competitiveness. The high-road Competition State is based primarily on the New Growth theory that posits that economic growth results not only from the endowment with capital, but is also related to the level of human capital, research and development or the quality of infrastructure (Romer, 1968; Sala-i-Martin, 2002). The low-road strategy, meanwhile, is more based on the neoclassical approach where the state's best approach is to abstain from any interference in investment decisions and reduce the costs of doing business, including the labour costs. The above economic theories, and the associated strategies, also have quite different distributive consequences and lead to different outcomes for the position of labour. The New Growth theory and the concomitant high-road strategy is based on higher investments in human capital that, at least potentially, provide for higher waged employment while it is also more tolerant towards social contributions as part of the overall labour costs since the key element of a countries' attractiveness to investors are the skills of its labour force, rather than its cost. On the other hand, the *laissez-faire* low-road strategy is based primarily on cuts in labour costs, including social contributions, and is not coupled with the expansion of public provision of skills. On the economic policy side, high-road strategy is also marked by higher 'interventionism' of the state in the sense of a more direct involvement of the state in investment decisions through targeted investment incentives and subsidies, while the low-road route is based on a hands-off approach where the state decreases taxes, and does so in a neutral way in order not to distort the investment process.

The fact that different economic theories have different distributive consequences means that these variances are also likely to be translated into the political arena – but only to the extent that the latter is indeed shaped primarily by distributive issues. In other words, the expectation is that the incorporation of different economic theories into different political party programs depends on the structure of the political system and the main axis of competition among political parties: in countries in which the latter is indeed structured predominantly by socio-economic left-right issues, the different economic theories will be more likely to find their way into the electoral arena than in countries where political party system is structured primarily by competition on other issues, such as political accountability or identity issues. Looking to the different implications of these theories and the associated state policies, we can observe that the high-road Competition State would be closer to the left, social-democratic, political pole as it is much more tolerant of higher wages and, at the same time, acts to expand public employment in the education sector or in sectors charged with managing and channelling private investment. The low-road route, meanwhile, would correspond more to the liberal political agenda. However, and somewhat in contrast to the common partisan approach in political economy that focuses primarily on differences in levels of social spending or in the size of the public sector conceived as compensation for economic openness, the argument here is that the higher social generosity or more interventionist approach in the high-road Competition State does not represent simply compensation or the reconciliation of economic growth with social concerns. As a matter of fact, the very idea that the two have to be reconciled already pits growth and social security against each other (see Block and Evans, 2005 on the sterility of the opposition between accumulation and social cohesion). Rather, it is the *economic* ideas and program underpinning high-road Competition State that recognise state intervention as a legitimate way to increase growth. This is what makes New Growth theory similar to the historical precedents of Keynesianism or the Rehn-Meidner economic model in which certain types of state policies that benefit labour (demand-management or solidaristic wage policies) were also seen as beneficial for the broader social strata as they were supposed to foster economic growth. Indeed, as Przeworski (1985: 43) argues, historically the task of Social Democrats has always been to find a way to bind together the interests of labour and capital, due to the structural dependence of the state on investments and economic growth as the source of revenues to fund their other policies – a structural dependence which has become even more pronounced today due to increased capital mobility. However, in order to gain the majority of votes in a context where the working class was never above 50%, the distinguishing feature of the Social Democratic program, or more precisely its formula of success, is to present the furthering of workers' interests as being advantageous to society as a whole (Przeworski, 1985: 27). In the period of 'embedded liberalism', the solution was a Keynesian theory according to which workers' wages and government spending are seen as a means of increasing demand and, thereby, fostering economic growth. A similar theory was that of the Rehn-Meidner model in Sweden, according to which high wages and low wage dispersion together are an instrument for fostering productivity – again leading to increased economic growth. It is important to note here that neither Keynesianism nor the Rehn-Meidner model imply that economic growth is 'reconciled' with social concerns. Rather, the generous social policies are themselves seen as being good for increasing economic growth. To some extent, the New Growth Theory has today taken over the role of the Keynesian theory – since investment in human capital and the public provision of education and skills are beneficial for workers and skills-providers but are, simultaneously, seen as beneficial for economic growth and thus beneficial for the society as a whole. Third Way Social Democracy, with its emphasis on workers' skills and knowledge as a driver of competitiveness, can thus be seen as yet another example of Social Democrats attempting to square the circle and present the interests of their electoral constituency – workers and public sector employees – as being in the interests of society as a whole. Hence, the left-right differentiation among political parties does not imply simply that some parties advocate more state generosity for the sake of social solidarity – it means that parties also have different ideas and different views on economic strategies for generating growth.

The combination of policies identified here as a high-road Competition State will thus naturally be the preferred strategy of the political left, while the minimalist low-road Competition State will be more favoured by the political right. Indeed, it has been argued by Boix (1998) that left and right have different supply-side strategies – with Social Democrats focusing on the provision of education and increased public investments, and liberals focusing on increased private investment. In contrast with Boix's analysis, the difference in supply-side strategies noted here is not simply one between public and private investment but, rather, comes to light as a difference in strategies for increasing private investment. More specifically, through providing incentives for specific investment projects rather than offering a low-tax environment, the state still retains a more activist role in shaping what *kind* of investment takes place and whether it is the one that brings high-value added production and higher wages to the country or the type of activities undertaken and the level of value added are entirely dependent on investors' decisions. Hence, the left strategy elaborated here is centered on private rather than public investments, but it still gives a more active role to the state than the neoliberal route.

Nevertheless, by showing distinct partisan preferences for competitiveness-enhancing strategies, the thesis does not argue that it is simply the colouring of the ruling party that determines state policies. Rather, the argument is that it is the structure of the political party system that determines whether different economic theories and strategies come to be translated into political party programs. The partisan approach to explaining social and economic policies has a long tradition in political economy, from Hibbs' partisan theory of the choices between inflation and unemployment (Hibbs, 1977) and Korpi's and Esping-Andersen's elaborations of party politics as 'democratic class struggle' (Korpi, 1983; Esping-Andersen, 1990) to the more recent studies of Garrett (1998), Boix (1998), Huber and Stephens (2001) and many others. The main assumption of partisan theory has been that the different party families (social-democrats, conservatives and Christian democrats) have distinct preferences for social and economic policies. Policy outcomes have thus typically been directly associated with the strength of the left party in government, with left parties assumed to prefer higher welfare state generosity as well as a more 'interventionist' economic stance. As elaborated by Häuserman et. al. (2013), the traditional partisan approach has recently been criticized in the welfare state scholarship and amended by showing that the policy positions of political parties cannot be taken for granted since they also depend on the structure of party competition – with left parties advocating different policies depending on what kind of a competitor they face on the right or the left of the political spectrum (Kitschelt, 2001). Furthermore, other scholars have argued that parties have become less responsive to their electorates, or that the structure of their electorates has changed. However, all of these amendments to the partisan explanations of social and economic policies still assume that party competition indeed *is* based on distributive issues and that the socio-economic cleavage is, at least, amongst the most dominant cleavages structuring the party system. Thus, the strength of the left party or a government of Social Democrats can result in a more generous welfare state or more labour-friendly policies overall only to the extent that the 'left' indeed is a socio-economic left – and only to the extent that one can indeed speak about a Social Democratic party existing in a country in the first place.

However, this is an assumption that cannot be taken for granted once the scope of the analysis includes countries with patterns and a timing of democratization different to those of the core of Western Europe. Rather than focusing on individual parties, the focus here is on the characteristics of party *systems* – in other words, different economic ideas and different supply-side strategies will become parts of different political programs only to the extent that the political system is actually shaped by socio-economic left-right issues. If, on the other hand, the main axes of competition among political parties are constituted by other issues – notably, political regime or identity issues – such a translation is less likely to take place and the result will instead be the hegemony of only one theory and strategy for increasing competitiveness.

Partisan theories in comparative political economy scholarship based on Western Europe could easily assume that the socio-economic cleavage would be dominant in a given party system because almost all West European political systems do have socio-economic differentiation as, at the very least, one of the main axes of competition among political parties. However, even in the West there were some exceptions to this pattern, with Ireland being an important example of a country in which the socio-economic cleavage never gained as much prominence as in the rest of Western Europe because the party system remained shaped primarily by a cleavage associated with national independence issues (Korpi, 1983; Mair, 1979). With the democratization of the Eastern part of Europe, the dominance of a socio-economic cleavage can be taken for granted even less in European capitalist democracies as socio-economic issues did not actually constitute the main source of contention nor the main axis of competition among political parties in the party systems developed in the East after 1990. The process of democratization in the East was part of the more complex simultaneous 'transition' from socialist to capitalist economies, and ran parallel to the process of nation-state building in many countries, so the dilemmas associated with this simultaneous triple transition have had a profound influence on the formation of the political systems in these countries – producing not only socio-economic, but also identity and political regime issue divides, as sources of contention among political parties (Elster et. al., 1998). Furthermore, political systems theory, and its application to the problem of simultaneity in Eastern Europe, assumes hierarchical relations among these three levels – in other words, the questions of 'who we are' and 'how should we reach collectively binding decisions' precede that of 'who gets what' (Easton, 1957; Offe, 1991). Consequently, politics in the new European democracies was only assumed to revolve around socio-economic left-right issues to the extent that the nation-state building process and the establishment of functioning democratic institutions were successfully resolved. The implications of the political systems theory for the developments of *party* systems would thus be that the resolution of these triple transitions will be translated into the axis of competition among political parties, with party politics in different countries being formed around socio-economic issues only in those countries that have finished nation-state building and have successfully consolidated their democratic institutions. As will be shown in the subsequent chapters, the path of democratization turned out to be protracted in Slovakia, with the country experiencing a deterioration of its democratic institutions and the emergence of a semi-authoritarian regime in the 1990s, which in turn shifted its political system towards second-order politics centered on political regime issues rather than third order socio-economic ones.

The argument is thus that it is the structure of party system rather than simply the colouring of the ruling party that determines whether different economic strategies indeed will be adopted by different political parties and whether the policy menu available to states even in the context of transnational capitalism will actually be represented in a given political system. Furthermore, to the extent that both the left and right strategy for increasing competitiveness are present in the political arena, it may be more difficult even for the right-wing parties to fully implement the minimalist state agenda due to opposition from the beneficiaries of the previous policies. On the other hand, in political systems in which the main axis of competition is based on national identity or institutional accountability issues, a right-wing neoliberal agenda may be easier to implement since it can be tied to *other* sources of legitimacy and support for the right-wing parties, such as national independence or political liberalization. Hence to the extent that neoliberalism indeed emerges as the only agenda to which, as Margaret Thatcher would put it, 'there is no alternative', the argument here is that such a lack of alternatives is shaped more by political than by economic factors.

The following chapters will show how the characteristics of domestic political systems in fact produced, or failed to produce, alternative economic agendas in the Czech Republic and Slovakia, leading to their transformations into high-road and low-road Competition States respectively. Both the Czech and Slovak Competition States appeared as responses to the crises of national capitalisms that these states experienced in the late 1990s. Despite important differences in the overall structure and functioning of Czech and Slovak national capitalisms, the main economic features of their crises were similar – including the lack of transparent and functioning corporate governance institutions, the associated lack of enterprise restructuring, bank failures, rising current account deficits and currency crises. While the economic features of the crises were similar, and were what actually prompted both states to turn into Competition States in the first place, the politics of crisis and crisis resolution were dramatically different in these two states and it was primarily these political developments that set them on their respective tracks. The differences in political developments can however only be traced by analysing the coevolution of economic and political systems during the 1990s when both national capitalism and national political institutions were being built simultaneously. Briefly, while both the Czech Republic and Slovakia resolved the early dilemma of simultaneous transition through the 'materialist politics' of compensation for market liberalization (Bohle and

Greskovits, 2012), the specific strategy of national capitalism building in Slovakia led to a deterioration of the democratic institutions and the emergence of politics centred on institutional accountability issues. Consequently, by the end of the 1990s, 'materialist politics' in Slovakia was replaced by 'idealistic politics' which enabled the emergence of neoliberalism as the hegemonic paradigm of state transformation. In contrast, politics in the Czech Republic remained firmly focused on socio-economic left-right issues, fostering the emergence of two different strategies – one neoliberal and the other 'third way' social democratic – of state transformation, with the electoral victory of the social democrats securing the implementation of the Competition State project. Before turning to an extended elaboration of the evolution of the Czech and Slovak states, the next section will briefly summarize the main political and economic developments in the early years of their transformations into capitalist democracies when they were both still part of the same state – the Czechoslovak Federation.

PRELUDE - DUAL TRANSFORMATION IN CZECHOSLOVAKIA

Introduction

Slovakia and the Czech Republic started their transformation from socialist to capitalist economies as a single country - Czechoslovakia. However, even in this period there were already some important differences between the two parts of the Czechoslovak Federation, both in their economic structures and in the political decisions over the best approach to reforms. In fact, their different stance on the best path for economic transformation were among the most important reasons for the eventual split of the country – yet, at the time these differences appeared the exact opposite of what would be by 2007. Indeed, for an observer in 1992, nothing would seem less likely than Slovakia ending up as a free market role model and an example of the starkest form of neoliberalism, with the Czech Republic ending up as a very generous welfare state and one of the most generous hosts for industrial foreign investment among the post-socialist countries. It is indeed ironic that Slovakia, as the state that gained its independence precisely *because* its leaders were opposed to the free market reforms designed in Prague, turned out to be the closest approximation of an ideal-type neoliberal state. Paradoxically, it is precisely because of this initial strong opposition to free market reforms, which was to result in an inward-oriented form of national capitalism building that threatened not only the economic success but also the democratization of the country, that the neoliberal template could be so thoroughly and radically implemented 10 years down the line.

The main aim of the following section is to briefly sketch the most important developments during the Czechoslovak Federation as it is in this period that, through privatizations and some early economic and social reforms, the foundations were laid for the subsequent development of the Czech and Slovak national capitalism models. The aim of this thesis, however, is *not* to explain the differences between Slovakia and the Czech Republic in the early 1990s nor their specific choices of post-socialist paths to economic and political transformation – there is ample literature on that, both comparing the two countries, as well as focusing on or including only one of them in a comparative framework (Deegan-Krause, 2006; Gould, 2011; Appel, 2004; Myant 2003; Stark and Bruszt, 1998; Bohle and Greskovits, 2012, to name just some). Rather, the main explanandum of my thesis is the increased divergence of Czech and Slovak state strategies from the end of the 1990s onwards – the argument being that in the late 1990s the two states actually shared important features so that the mid-1990s are the starting point from which divergence is observed and explained. However, by proposing that these *states* – operationalized earlier primarily according to their fiscal and social policies – were largely the same in the 1990s, the argument is not that their national capitalisms at the time were the same. As a matter of fact – and as is already acknowledged in the literature - there were important differences in the features of their national capitalisms so the argument here is that it was these very differences that really set them apart and fundamentally shaped their strategies towards building transnational capitalism in 2000s. That said, the differences of their national capitalism in the 1990s, in particular the differences in the Czech and Slovak political systems and patterns of democratization, figure in this thesis as the *explanans* rather than *explanandum*. Thus, the section on early Czechoslovakian reforms is used purely to prepare the ground for a more detailed discussion of the similarities and differences of the Czech and Slovak political and economic formations of national capitalisms in the 1990s.

Economic reforms in Czechoslovakia

The Czechoslovakian pattern of extrication from socialism occurred by way of capitulation, rather than a compromise or electoral competition (Stark and Bruszt, 1998) and, consequently, the political elites presiding over the process of economic transformation in both countries came out of broad 'umbrella' political movements, rather than parties – namely, the Civic Forum (OF) in the Czech part of the Federation and Public Against Violence (VPN) in the Slovak part. Both the Czech Civic Forum and Slovak Public Against Violence thus united a broad spectrum of organisations and individuals with very different political views, whose main common denominator was the struggle against the state-socialist regime. However, the precise composition of these movements differed considerably. The Czech OF was led by two groups with quite different ideas on what post-socialist reform was supposed to look like. One group consisted of dissident intellectuals, the most famous of which was Vaclav Havel, and was primarily concerned with building a 'good' and 'just' society, strengthening civil society (including the trade unions) and endorsing the somewhat paradoxical politics of anti-politics. Another group consisted of former socialist reform-minded technocrats primarily interested in the contours of the new socio-economic system which they envisioned as being as close as possible to the ideal-type neoclassical markets. The most prominent among these was Vaclav Klaus, the Federal Minister of Finance, who was inspired primarily by the monetarist and neo-liberal ideas of Thatcher and Friedman. The economic preference for neoliberalism and individualism also corresponded to the political preference for insulated policy-making free of any influence from trade unions or other civil society organizations. The uneasy alliance of technocratic neoliberals and dissidents closer to social democratic ideals did not last long and, soon after the elections, it would become the basis for the differentiation of Czech political parties.

However unusual this alliance was, it is very important here that is was fundamentally different from the alliance of political actors the gathered within the Slovak Public Against Violence (VPN). Crucially, the Czech-style dissident current– pro-democratic, pro-civil society and close to social-democratic economic positions – was very weak in Slovakia, represented as it was by Miroslav Kusy and only a handful of others (Szomolany and Gould, 1997). The roots of this can be found as early as the normalization period of the socialist regime – when the Communist party restored its firm rule after the Prague Spring – which was less harsh in Slovakia than in the Czech Republic and was based on the co-optation of the reformist current in the Slovak communist party, rather than its expulsion into dissident lines. The Slovak post-socialist elite thus came primarily from the lower and middle ranks of the previous communist elite, so the VPN represented a broad alliance of economic liberals such as Ivan Miklos and some less reform-minded former communists.

As in other post-socialist countries, the first reforms were governed by the idea that a socialist economy represents the single biggest obstacle to economic growth and development – the lack of private property was seen as a major hindrance to economic development and the main reason for their backwardness relative to Western Europe. Hence, the most important reforms were fully in line with the Washington Consensus recipes: privatization, liberalization, stabilization. Still, despite agreeing on the fundaments of the reforms needed for the creation of market economy, there were important political differences and debates on the more precise speed and content of reforms. These debates in Czechoslovakia followed the same lines of argument as those in other post-socialist countries and can broadly be described as the battle between 'neoliberals' or the advocates of radical 'shock therapy', on the one side, and 'gradualists' on the other. Social interest groups were at the time also in favour of 'gradualist' approaches – the Confederations of Industry of both the Czech and Slovak regions jointly delivered a 'Petition to the Federal Parliament' in February 1991 demanding continued subsidies, looser and cheaper bank credit and a slower pace of reforms (Gould, 2011). Trade unions, for their part, also tried to moderate the reforms initially. Both of these attempts were, however, ignored by the Federal government where the battle between the two currents was won by the proponents of the shock-therapy approach. Thus, by 1992 Czechoslovakia had implemented rapid liberalization of trade and prices, as well as a voucher-model of large-scale privatization with the aim of privatising state owned enterprises as soon as possible

Nevertheless, while in the Czech Republic the conflict between 'gradualists' or 'industrialists' and neoliberals represented a conflict among economists and political elites with the domestic economic elite having very little say in the process (Appel, 2004), in Slovakia the conflict over economic reforms turned into one between, on the one hand, neoliberal economists and politicians and, on the other, nationalist 'opportunists' (Vachudova, 2005) in the form of the political party HZDS led by Vladimir Meciar and closely allied with the former socialist managers. Thus, while the domestic managerial elite turned out to be unsuccessful in influencing the pace and direction of reforms at the Federal level, they were much more successful in forging alliances with politicians at the Slovak national level. Consequently, the gradualist or 'left' camp in Slovakia was captured by the domestic managerial elite from the very outset (Appel, 2004; Gould, 2011). As noted earlier, the explanation for the differences in the relations between the political and economic elites in the two parts of the Federation stem from the period of socialist 'normalization' after the Prague Spring of 1968, when there was severe political repression of Czech dissidents active in the Prague Spring and Doubcek reforms. Meanwhile, the approach in Slovakia amounted primarily to the federalization and the empowerment of the local communist elite as well as some stronger attempts to equalize the two parts of the Federation with the consequence of broadening the ranks of the economic managerial elite through substantive upward mobility (Szomolany and Gould, 1997). At the same time, while Czech reformers were purged from the ranks of the Communist Party, Slovak ones were largely allowed to retain their positions having signed the Warsaw Pact on 'international intervention' in Czechoslovakia. The consequence was that, while in the Czech Republic the struggles over the course of economic reforms represented the struggles *among* former dissidents, in Slovakia they constitutes a struggle between Christian Democratic and neoliberal dissidents on the one side and 'opportunists' allied with the old economic elite on the other. These differences in the approach to reforms eventually led to the split of the country.

The struggle was particularly fierce and important regarding the design of the privatization framework. The debates on privatization went along lines similar to those of the debates on other economic reforms, with 'neoliberals' advocating rapid and radical reforms and 'gradualists' advocating a slower speed of the reforms and an even larger role for the state in the process of economic transformation. In the context of privatization, debates revolved around the adoption of the best model, with the approaches differing along the following dimensions: foreign versus domestic ownership; spontaneous privatization versus privatization controlled and directed by state agencies; institutional versus natural ownership; and concentrated versus dispersed ownership (Stark and Bruszt, 1998). In Czechoslovakia the main proposals were, on the one hand, the voucher privatization scheme advocated by the Minister of Finance, Vaclav Klaus, and elaborated by his neoliberal economist colleagues Ježek and Triska and, on the other hand, the different proposals of gradual privatization on case by case basis with a larger role of the government in the process. The debate was heated, with neoliberals emphasising the principle of justice and equal treatment of all citizens, while the 'gradualists' warned that this equity was actually illusory, that the national wealth shouldn't be just given away for free, and also that the voucher method would facilitate the rise of organized crime, elite fraternities and money laundering (Schwartz, 2006). However, the rapid privatization and voucher model advocated by Klaus and strongly supported by the IMF eventually became the key feature of the Czechoslovakian economic reform. There are several reasons why the voucher privatization proposal turned out to be politically stronger: first, it directly involved citizens in the process thus ensuring higher public support for the property transfer; secondly, it excluded foreigners from privatization thus tapping into public fears of a foreign, in particular German, takeover of Czech industry (according to the public opinion surveys of the time a majority of the population opposed sales to foreigners); third, as opposed to the insiders' oriented models, it did not give any preferential treatment to managers of state-owned enterprises which were largely considered to be communist nomenklatura and were highly ostracized in public perception; and finally it brought to a logical conclusion the premise that the state is the worst possible owner, from which it follows that the state is also the worst possible manager of privatization. Finally, given the low savings of the population which would preclude direct sales to domestic owners, voucher privatization was the quickest possible way of proceeding with the reform while still excluding foreigners from the process.

As stated earlier, Czechoslovakia did not have high debt like Hungary. Hence privatization was not used as the means for the state to obtain revenues - the key goal was to achieve the transformation of property relations as quickly as possible. The Privatization Law was adopted in February 1991, according to which every adult citizen was given the right to purchase a book of coupons at a nominal fee, which she could than exchange for shares in state enterprises scheduled for privatization (Goldman, 1999). The first wave of voucher privatization was completed by December 1992 and, despite a slow start, by the end of 1992 between 75 % and 80% of Slovaks took part in it and more than 70% invested their vouchers in 165 privatization funds (Goldman, 1999). Still, the first round turned out to be the only round of voucher privatization in Slovakia since, after the independence, Meciar managed to block the second round in 1994 and the preferred model from then on became direct sales.

At the same time, however, besides the predominant voucher model, some state enterprises were still scheduled for direct sales and were offered to foreign investors. The access given to foreigners in the privatization framework was yet another point of contention. Not all gradualists agreed with this opening up to FDI at the time and, as a matter of fact, many of them advocated an insider model of privatization favouring either managers – in the case of Miroslav Gregr then president of the Czech Confederation of Industry and the Minister for General and Electrical Engineering – or workers' ownership, in the case of Milos Zeman, Civic Forum's deputy in the Parliament and subsequent leader of the Social Democratic Party and Prime Minister (Schwartz, 2006). Nevertheless, those in the state bureaucracy that were more open to FDI, and who even in the 1990s saw the involvement of foreign investors as the best route towards modernising enterprises and upgrading their products and processes, were still closer to the gradualist camp and were part of the political opposition to the neoliberal circle around Klaus, rather than subscribing to the neoliberal political program. Among the latter, a prominent role was played by the Minister of Industry and Trade, Jan Vrba, who from the very beginning openly opposed the voucher model and instead advocated the establishment of joint ventures with foreign investors that would ensure the transfer of technology and managerial know-how which could help upgrade the existing industrial structure. Although Klaus disagreed with Vrba on this point, a compromise still had to be made and the informal agreement they eventually achieved was that only those enterprises for which a suitable foreign investor could not be found would be offered for voucher privatization (Appel, 2004). Thus, even in this early period, several important deals with foreign investors were concluded – the most prominent one certainly being Volkswagen's acquisitions of the Czech operation Škoda and the Slovakian Bratislavske Automobilove Zavodi in 1991. Furthermore, the openness for FDI was signalled by the establishment of government agencies for foreign investment in both parts of the federation: CzechInvest in the Czech Republic and the Slovak National Agency for Foreign Investment and Development (SNAZIR) in Slovakia. These times of relative openness to FDI however ended in 1992 – with the electoral victory of nationalist-oriented leaders both in the Czech Republic (Vaclav Klaus) and in Slovakia (Vladimir Meciar). With the subsequent split of the country, nationally oriented models were adopted as the decisive privatization strategy in both states. Nevertheless, while CzechInvest – despite Klaus' opposition – maintained its position as the main strategic point for negotiating with foreign investors, the Slovak SNAZIR turned out to be much less successful and is now barely remembered. The FDI-oriented path of economic transformation, whose seeds were sown in the first years of the Czechoslovak post-socialism, thus remained as a marginal, but nevertheless existent path in the Czech Republic, while it was largely side-lined in Slovakia. What is very important, though, is that this path was from the very beginning part of the *opposition* to neoliberalism, rather than being an integral part of the neoliberal program. In other words, while conventional wisdom would identify externally oriented strategies and FDI attraction with laissez-faire neoliberalism, the Czechoslovak and subsequently Czech cases demonstrate that relying on foreign investment can indeed be part of very different economic strategies and is not necessarily associated with textbook neoliberal ideas.

Back to the roots – resurrecting the pre-socialist Welfare state

Economic reforms and the associated transitional recession in Czechoslovakia were accompanied by a number of social reforms that aimed at alleviating the worst consequences of economic dislocation. As was the case with other Eastern European countries, the shift from socialist to market economy meant that a welfare system based on full employment and enterprise benefits had to be replaced with one featuring open unemployment and the disappearance of enterprise benefits. The rise of the 'emergency welfare state' (Inglot, 2009: 73) in Czechoslovakia thus encompassed the expansion of early retirement, the establishment of an unemployment compensation system and a network of labour offices as well as some attempts at building a social safety net. Social protection systems at the time were not high on the agenda of international financial institutions and their advisors, so national leaders were thus left to develop their own systems without clear templates from abroad. Furthermore, the fact that after the end of socialism Czechoslovakia was run by two very broad umbrella-type social movements also meant that the ministries in the federal government often reflected splits within these broad movements. Thus the Ministry of Labour and Social Affairs which designed the package of social reforms was staffed with 'gradualists' and some more social democratic-oriented officials, while there were technocratic neoliberals working in the Ministry of Finance and developing the package of economic reforms. The main aim of the social package was to alleviate the consequences of inflation and rising unemployment as the necessary corollary of economic liberalization – and the experience of Latin American and other countries that implemented the Washington-designed shock-therapy served as a reminder that social policies alleviating the accompanying social dislocation are necessary in order to avoid the political protests against the reforms (Tomes, interview).

The Czechoslovak Federation entered capitalism with a number of inherited welfare laws and institutions, many of which dated back to the mid-twentieth century or even earlier. For instance, the National Insurance Act of 1948, prepared in advance of the Stalinist *coup d'etat,* created a modern system of social protection based on near universal coverage and comprising a mixture of Bismarckian and Beveridgean elements, with the clear political imprint of the social democratic syndicalism that flourished particularly in the Czech reformist circles (Inglot, 2009). Subsequent reforms were implemented in the 1950s under the direct pressure from Moscow but, importantly, more liberal and social-democratic proposals were developed again in 1968. Although at the time these proposals were suffocated by the Soviet invasion, the ideas still remained and actually constituted the basis of the first social policy documents in democratic Czechoslovakia. The 'Scenario for Social Reforms' was passed at the Federal level in 1991 and was prepared by Igor Tomes, a social policy expert that had already written the social part of Dubcek's program during the Prague Spring. Tomes' expertise lay in the pre-communist Czech welfare state and his advocacy of insurance and the principle of individual responsibility, rather than the Soviet state-based model of welfare, saw him labelled as a dissident during the period of 'normalization'. After the Velvet Revolution, however, Tomes was invited to draft the new social laws and this meant that the door was open for a return to the traditional pre-communist welfare tradition, which was seen as yet another aspect of the broader process of the Czech people returning to their own history after years of Soviet-installed communism. The new social policy agenda thus heavily relied on these previous experiences and it included the implementing of universal compulsory health and social insurance as well as needs-based social assistance – the main idea being a mixture of Bismarckian and Social Democratic principles (Tomes, interview).

In 1992, social insurance was thus set to be compulsory and there was a move from tax-based systems, developed in line with the Soviet model, to a system financed from contributions by employers and employees. The indexation of pensions was also adjusted to account for changes in prices in order to prevent inflation from reducing the real value of pensions. In addition, the privileges in pension system that were preserved from the socialist period were abolished, with the elimination of the system, instituted in 1956, of categorising workers according to the riskiness of their occupation as well as the ending of special personal pensions for Communist nomenclatura and exceptional artists and sportsmen (Lesay, 2006)

The social safety net was established in 1991 by way of the provisions on minimum pensions, the establishment of a social assistance scheme as well as targeted family benefits. The social assistance scheme was based on the concept of the living minimum – the minimum level of income that could provide one with sufficient means for living, which in 1991 amounted to a 55% replacement of net average wage for a single person (Sirovatka, 2008). The scheme was administered by municipalities, but the costs were entirely borne by the state budget (Sirovatka, 2008). The early policies paid special attention to the dangers associated with inflation and price liberalization so, for instance, the State Compensation Allowance Act of 1991 instituted a monthly cash allowance of 140 crowns per household in order to compensate for the increase in the price of food following the abolishment of price controls. In addition, pension benefits were indexed to the rise of prices in order to avoid inflation radically reducing the value of pensions. Furthermore, the minimum living standard was increased, which allowed groups that fell below the poverty line to receive social assistance payments (Rueschemeyer and Wolchik, 1999). However, the economic recession in the first two post-socialist years quickly led the government to cut some of the benefits, such as adopting the 'better targeting' of family benefits and lower sick-pay and maternity benefits (Inglot, 2008).

Czechoslovakia also adopted an approach that emphasised an active employment policy, and defining the state employment policy as aiming at balancing the supply and demand of labour, productively utilizing human resources and securing the rights of citizens to employment. Hence, a workfarist emphasis on human resources utilization and productivity was apparent from the very beginning of the Czech and Slovak welfare state – with the right to work pertaining to all those who actively sought jobs. However, at the time the law also stipulated that these persons have the right to material security before starting employment and in the event of losing employment (Potucek, 2004). The replacement rates of unemployment benefits were not extremely low: 60% for the first three months and 50% for the next three months of receiving benefits, but the duration of unemployment benefits was fairly low by international standards – just 6 months, after which an unemployed person was only entitled to means-tested social assistance benefits (Saxonberg and Sirovatka, 2009). Furthermore, from the outset, the provisions setting out the 'suitable job' that the unemployed person had to be willing to take in order not to lose benefits were quite broad – previous qualifications were not necessarily relevant and only health status and family circumstances, such as caring for children or persons over 80 years old, were taken into account (Sirovatka, 2008). An extensive network of labour offices was created in the regions with the task of administering state employment policy and nearly 200 state employees were sent to Germany for training in running these labour offices (Tomes, interview).

Overall thus, social policy at the time was based on three main components: liberalization and pluralisation of social welfare based on a Bismarckian insurance system and inspired by the early Czech welfare state with roots dating back to the end of the 19th century; the development of a social safety net for the people in need; and an active employment policy (Potucek, 2004). As will be shown in the later chapters, most of these institutions and principles were retained in the two new independent states throughout the 1990s.

Conclusion

Similar to other East European countries, the Czechoslovak exit from socialism was accompanied by a widespread debate on the speed and form of economic transformation, the most important part of which was privatization. Politically, thus, the beginning of the transformation in Czechoslovakia was marked by predominantly materialistic politics (Bohle and Greskovits, 2012) and struggles over the course of economic reforms. The Federal Government embarked on a process of economic transformation and liberalization, while building the 'emergency welfare state' (Inglot, 2009: 73) as a form of compensation for the social dislocation caused by economic liberalization. Furthermore, thanks to its legacy of bureaucratic-authoritarian socialism (Kitschelt et. al., 1999), political conflicts in Czechoslovakia were very much centred on the differences in the approach to economic reforms, with 'gradualists' or 'industrialists' being pitted against neoliberals. Nevertheless, while in the Czech Republic the conflict between industrialists and neoliberals represented a conflict among different currents of dissident economists, in Slovakia they represented a struggle between dissidents and 'opportunists' allied with the old economic elite. The existence of separate republican institutions, however, also enabled those groups not satisfied with the approach at the Federal level to support the political forces that would lead to greater autonomy and eventually cause the split of the Federation. In other words, the battles on the different approaches to reforms could be translated into the disputes on the correct institutional framework and the questions of national autonomy in the Federation. The birth of the separate Czech and Slovak states after the fall of socialism can, to a large extent, be attributed precisely to the political conflicts over the fundamentals of the new social and economic order – it was essentially an affair of the elites, as most of the population actually supported some kind of Federation (Szomolanyi and Gould, 1997). However, the differences apparent amongst the protagonists and content of this conflict in the Czech and Slovak parts of the Federation persisted during the first years of their national independence.

Consequently, the electoral victory won by the neoliberals in the Czech part of the Federation saw them proceed with their independently designed strategy for building national capitalism. Meanwhile, in the Slovak state the rise to the power of 'opportunist' HZDS led to the capture of the transformation process by the domestic economic elite with severe consequences for the development of Slovakian democracy. As will be shown below, the political differences associated with the different political legacies of socialism, and already apparent in the early years of the Czech and Slovak models of capitalism, thus played an important role in the shaping of Czech and Slovak national capitalisms, as well as in their shift to building transnational capitalism.

CZECH REPUBLIC – RACE TO THE TOP

Building national capitalism – Czech partial neoliberalism (1993 – 1998)

Introduction

Transnational capitalism in the Czech Republic and Slovakia was built from the remnants of national capitalism – and in order to understand the politics of their Competition States we have to delve into the reasons how and why these national capitalist formations fell apart, since the politics of the crises of national capitalism had a profound impact on the strategies for building transnational capitalism. In this section I thus focus on the experience of the Czech Republic with building national capitalism – the experience that I describe as the neoliberal partial reform trap. Its neoliberalism was partial in two ways. In terms of economic policies, and privatization in particular, it was neoliberalism regarding the extent and the speed of trade and price liberalization, as well as the model of privatization based on the idea of turning all citizens into shareholders. However, this neoliberalism was still partial since banks remained state-owned and thereby represented a crucial stabilizing element sustaining other privatized enterprises. The partial character of Czech neoliberalism is also apparent in the reluctance to implement a strict bankruptcy law as well as in postponing corporate governance and financial markets regulation – in other words, all the laws that would actually enable markets to start properly functioning. In terms of social policy, Czech neoliberalism was also partial in the sense that it was coupled with the re-establishment of the welfare state based on the tradition of pre-socialist social insurance systems. Hence, neoliberalism was not the guiding principle in the social policy reforms and, to that extent, the neo-Polanyian accounts stressing the balancing of marketization and social protection in the Czech case certainly hold true for the initial years of the transformation (Bohle and Greskovits, 2012). However, this would be much less true for Czech social reforms of later periods.

Despite the neoliberal ideas underpinning Czech national capitalism building, it still led to the emergence of partial reform equilibrium (Hellman, 1998) and the capture of the transformation process by the early transition winners, which eventually led to the collapse of the Czech national capitalism model. However, in contrast with Slovakia, this model was not predicated on a severe breach of democratic procedures – owing to the particular mode of privatization used, its winners were still much more dispersed and in conflict with each other than was the case in Slovakia. Consequently, the economic failure of Czech capitalism was simply that – an economic failure. The shift in economic strategy came about as part of the normal shift of government, *not* as the succession of a competitive authoritarian regime by a liberal democratic one. The politics of transformation and transnationalisation could thus still remain polarized around the issues of economic reforms and the best strategies to regain economic growth once it became obvious that the national model failed. Further, despite the consensus across the political spectrum that the country should open to foreign investors, there were still important and politicized differences as to how this reorientation towards foreign investment should be brought about, differences that profoundly shaped the politics of transnationalisation in the Czech Republic and had a decisive influence on the shape of its Competition State.

The section begins with an overview of the Czech path of economic transformation, including its privatization method as well as welfare state reforms. It continues by sketching certain parallel political developments in the Czech Republic – demonstrating that, due to its particular method of privatization, both the initial democratic achievements and the stabilised party system remained intact throughout the processes of economic transformation and remained focused on socio-economic left-right issues. The section concludes with an overview of the crisis of the Czech model of national capitalism that prompted the state to transform into Competition State but which, however, remained a purely economic issue, with political parties developing different state projects and different proposals for building transnational capitalism.

Economic transformation – neoliberal partial reform equilibrium

The first years of Czech independence saw a period of rule by the Obcanska Demokraticka Stranka (ODS), led by Vaclav Klaus, marked by rapid and apparently profoundly liberal reforms in the economic sphere, the hallmark of which was voucher privatization, accompanied by much less radical and less liberal reforms in the social sphere. After the 1992 elections, a coalition government was formed by the ODS, the Obcanska Demokraticka Alianca (ODA), and the Christian Democratic Union – Czechoslovak People's Party and Christian Democratic Party. The economic strategy in these years could best be described as an attempt to build national capitalism through rapid transformation and a variant of neoliberal shock-therapy. This internally oriented strategy in the Czech Republic actually had some parallels with the internally oriented strategy in Slovakia – and the statistical analysis from the earlier chapter shows that in the mid-1990s these two states actually still shared many important features. Politically, they were both run by nationalist parties with charismatic leaders, both of which had the idea of creating genuinely national capitalism, either through the creation of 'kapitalotvorna vrstva' (capitalist stratum) as envisioned by Meciar, or through the creation of small-shareholder capitalism with an important role for successful and exceptionally dynamic national entrepreneurs in the vision of Vaclav Klaus. Both of these states were also very slow with bank privatization, using the protracted state ownership of banks as a means of providing lifeblood to privatized enterprises through soft lending practices. Finally, both of these states continued the practice of social compensation through preserving the welfare state institutions established in the Czechoslovak Federation.

Drahokoupil (2009: 36) labels the Visegrad states at this point neoliberal transformational states – referring primarily to their main goal of turning their command economies into market-led ones and implementing the standard Washington consensus package of policies: liberalization, privatization, stabilization. The label 'transformational' is certainly well put – the 1990s were definitely a period when these states were indeed transformational or system-changing states whose primary action was the shifting of their economies from socialism to capitalism. The Czech Republic and Slovakia were, moreover, also clearly concerned with the creation of *national* capitalism. However, calling these states neoliberal might be stretching that concept, especially if they are compared with the neoliberalism of their Baltic counterparts. A more accurate description is provided by Bohle and Greskovits (2012), for whom the 1990s represent a period of materialistic politics in the Czech Republic and Slovakia, with simultaneous liberalization and compensation in the form of social protection. Similarly, Mitchell Orenstein describes the initial Czech strategy of transformation as a mixture of neoliberalism in economic policies and social democratic tradition in labour and welfare policies (Orenstien, 2001). However, we should note that even the brand of neoliberalism found in their economic policies was of a questionable nature – as Martin Myant (2003) shows, Klaus' privatization was much less of a clear-cut implementation of a neoliberal template than is usually thought. This thesis sides with the latter approach – despite the adoption of the holy trinity of liberalization, privatization and stabilization, neither economic nor social policies in the Czech Republic in the 1990s were an example of pure neoliberalism. Although the Czech Republic rapidly liberalized trade and removed price controls, while also implementing the most market-based mode of privatization, it nevertheless substantively delayed bank privatization thus enabling the survival (albeit preventing the restructuring) of its industrial enterprises. On the one hand, the *partiality* of this neoliberalism and its various forms of protection from market liberalism probably helped secure political support for the regime transformation but, by preventing the restructuring of enterprise in the context of completely liberalized trade, it still led to the economic failure of Czech capitalism and the shift from an 'emergency welfare state' to a Competition State. At the same time, as is especially visible when we contrast it with Slovakia, it was also the *neoliberalism* of this partial reform trap that made it much less detrimental from the political point of view as basic democratic procedures were never called into question in the Czech Republic.

Voucher privatization – in search of Czech entrepreneurs

Among the economic reforms enacted in the process of building capitalism, privatization is certainly the most important one. It is a process that creates winners and losers, one that creates employers and employees, and has profound influence on the future character and development of capitalism in the region. Through its fundamental role in shaping societal power relations, it also has an immense influence on the future political developments because it creates the stakes that can be lost or gained in the subsequent changes of the party in government – if the latter are too high and the privatization winners are very concentrated there can be adverse effects on democracy as any change of government will have to be prevented by all possible means (Gould, 2011).

As is well known, privatization in the Czech Republic had many adverse consequences, from the lack of any clear control over managers to an institutionalized conflict of interest among banks as creditors and banks as owners, all of which ultimately led to the economic failure of Czech national capitalism. However, in contrast to Slovakia, it did *not* have adverse consequences for political developments nor for the existence of democracy as such – its winners were too dispersed and in conflict with each other to allow the creation of a stable block that could both block further economic reforms, and that would be motivated to do so because the cost of losing political power would have been too high for them to let the democratic elections game take place.

The split of Czechoslovakia did not have major consequences for the path of economic reforms in Czech Republic – since the economists involved in designing the reforms were largely Czech and remained in the Czech government afterwards there was little disruption and the Czech Republic basically continued the approach already taken by the Federal Government. Thus, two waves of voucher privatization were successfully implemented – the first one concluding in May

1993 and the second one at the end of 1994, with approximately 6 million citizens taking part in the first wave and 6.1 million in the second wave (out of 7.4 million Czech citizens over 18). Public opinion surveys also showed that the model was popular among citizens – 63% of the surveyed supported voucher privatization (Appel, 2004: 60). Thus, by 1995 more than 70% of the economy was transferred to private hands. Still, in reality, state ownership was actually much larger – partly because the state kept a large block of enterprise shares for which no interested investor was found in either privatization wave, and secondly because the biggest owners turned out to be investment privatization funds, owned by the major banks which were in turn still owned by the state. Due both to general scarcity and unreliability of information about the companies and an intensive competitive advertising campaign by the funds, the IPFs gathered about 74% of all investment points in the first wave and 64% in the second wave – thereby, according to some estimates, obtaining control of around 30% of the privatized enterprises (Appel, 2004: 62). Since most of the funds were founded by the still state-owned banks, an immediate linkage arose between privatised companies, investment funds, banks and the state. Thus, voucher privatization allowed the major financial institutions to become co-owners of themselves and to create significant cross-ownerships, which resulted in numerous institutional conflicts of interests. Banks' ownership of funds and the funds' ownership of enterprise shares meant that banks faced a conflict between the need for enterprise restructuring and their own need to avoid bankruptcies. A common practice was for the banks to extend loans to undeserving companies in their portfolio, thus supporting a large number of unprofitable enterprises in order to protect their funds' assets.

However, the problem was not simply that the state directly or indirectly remained the owner of shares in enterprises, as the situation was even worse in case of purely private investment privatization funds. The biggest among them was The Harvard Funds, established by Viktor Koženy – Czech émigré and graduate of the Harvard Economics department. The Harvard Funds were the first IPF to advertise in the media, and they ended up as the third largest IPF, acquiring over 11% of the available coupon books. In 1994 Harvard Funds initiated a joint venture with an American company and sold all of its shares to this company, using the money to buy further stakes which, due to the 20% cap on ownership by a single fund in any given company, Harvard Fund could not have done on its own. Although they initially had the idea of becoming 'active owners' in at least some of these companies after the 'third wave privatization', they soon encountered troubles in agreeing on a strategy with other major shareholders and instead sold the remaining stakes to the latter. The trading activities of Harvard Fund thus simply contributed to the further concentration of the Czech economy in the hands of a circle of banks and financial and industrial groups, while at the same time brining huge gains to Koženy and his associate Dingman. In 1996 Harvard Funds found another company registered in Cyprus and transferred all of their shares to this company, in exchange for 50% of shares in it (the other 50% being in the ownership of Stratton Investment). With the headquarters being in Cyprus, the company had no obligation to disclose what was happening with the shares in its ownership, thus effectively taking them out of sight of the Czech citizens in whose name they were 'managing' the assets. Later, Koženy himself happily emigrated to the Bahamas (Myant, 2003).

Such practice was perfectly legal as the regulation of Czech financial markets was extremely lax and there were virtually no protections in place for small shareholders, so it was very easy for the investment funds to simply transfer shares to other companies and effectively rob the citizens. The lack of regulation was often justified by the tight timescale and the need for quick reforms – however, there are indications that it was actually done on purpose in order to 'let the sharks accumulate'. Indeed, the policy makers' idea was that voucher privatization would be only the first step in the transformation of property relations, with small shareholders expected to subsequently sell their stakes to 'active owners'. The idea of active owners, however, assumed that someone would be able to buy these shares - and given the starting position of a population with low levels of savings (which was one of the major reasons why voucher privatization was considered to be the only viable way of quickly privatizing with domestic buyers), the lax regulatory framework actually functioned as a means of allowing individuals to accumulate enough resources to buy the firms. Alternatively, it has also been seen as permitting them to take over the public enterprises *without* having the necessary resources (Myant, 2003: 117). As Jan Mladek, then an opposition CSSD economic expert and later deputy Minister of Finance, put it: it was 'privatization to people who had no money' (Mladek, interview).

This practice typically happened during the 'third wave' of privatization – i.e. after the citizens already transferred their vouchers into shares, placing them largely in the hands of privatization investment funds, with the residual shares still in state ownership. Especially in case of large enterprises, the government then reverted to putting its share up for 'competitive bids', in fact looking for a dynamic, entrepreneurial individual who would put the company on its feet. '*They had to choose from those with experience but looked also for enterprise and dynamism. In reality that impression was often created by a grossly inflated ego, nationalist rhetoric and absurdly unrealistic business ideas.*' (Myant, 2003: 212). An early example of such 'entrepreneurial' privatization with the government looking for a 'dynamic' persona to take over the jewels of Czech industry included the Škoda Plzen heavy engineering combine; examples during the third wave of privatization include the tram producer ČKD, Poldi steelworks, or Trinecke Železarni acquired by Moravia Steel company whose owner

Milan Šrejber was suspected of being behind a notorious 7.5 million CZK donation to the ODS given under false names in 1996 (Myant, 2003). Some of these companies ended up in domestic 'entrepreneurial' hands due to the lack of interested foreign investors – in some cases, however, the government explicitly rejected foreign investors, or the latter lost interest after realizing that a direct sale was not possible.

This mode of privatization actually see considerable similarities between the Czech and Slovak experiences – the only difference being that the owners of the enterprises in these murky privatization deals turned out not to be the enterprises' old socialist managers, but the new entrepreneurial elite with their unrealistic business plans and apparent 'dynamism' that the political elites imagined as a necessary prerequisite for business success (Myant, 2003: 212). The new entrepreneurs did not actually have the resources to acquire stakes in the companies and they typically relied on bank loans that they could not or would not pay back, often using the shares of the company themselves as collateral. Banks, meanwhile, found themselves under political pressure to sell the shares to the chosen entrepreneurs or, otherwise, to continue granting loans to enterprises that were clearly not able to repay them. Not surprisingly, the majority of these enterprises found themselves deeply in debt by the end of the 1990s and ended up in the new government restructuring program, while banks piled up huge amounts of non-performing loans.

Murky privatization deals were facilitated by a lack of any serious institutional oversight or regulation of financial markets. The initiatives for developing such regulation, as well as the initiatives pushing for bank privatization, were stymied by the 'winners' of this first stage of transition who had become interested in preserving the status quo – and in that sense Czech Republic indeed corresponds to the 'partial reform trap' described by Hellman (1998: 203). Thus, Klaus's ODS, the biggest promoter of rapid reform and neo-liberalism in the first privatization phase, later began to block further reforms and the implementation of Western models of financial and investment regulations. The absence of institutions such as a Securities and Exchange Commission or regulation securing minority shareholders' rights, weak corporate governance structures and the lack of managerial oversight resulted in widespread asset stripping by uncontrolled owners and managers. In a process called 'tunnelling', the dominant shareholders or managers would simply channel the assets of enterprises to new and smaller enterprises with a small group of owners, thus leaving empty shells on the verge of bankruptcy in place of previous enterprises.

Given the inherent weaknesses of the Czech model of building national capitalism, it is not surprising that, in the context of trade liberalization, this model reached its limits and failed to bring about the successful integration of the country in the global markets. Either through the mass privatizations undertaken without any oversight of shareholders over managers, or through the individual deals with domestic entrepreneurs whose business plans were far from realistic but who were nevertheless backed by state-owned banks, the state-induced national capitalism was certainly failing to bring about any enterprise restructuring that could foster export orientation and avoid the trap of a rising trade deficit and the concomitant currency crisis. The current account deficit indeed rose from -2.0 % of GDP in 1994 to -6.7% in 1996. Hence, the failure of the Czech model of national capitalism was the result of both the constraints of the transnational capitalism alongside trade openness and strong market integration as well as of its own internal weaknesses. However, contrary to Slovakia, the partial reform equilibrium created in the Czech case did not represent a threat to democracy as the dispersion of winners was higher than in Slovakia and the conflicts among them were more pronounced (Gould, 2011: 100). As a result, not only were basic democratic procedures kept in place, but the Czech Republic also maintained very good relations with the European Union and proceeded with its initial path of integration with the West. Consequently, the fall of Czech capitalism merely triggered a normal change of government and the further politicization of economic strategies rather than a complete reversal of the political regime. The change of government, however, brought about a shift in power from 'technocratic neoliberal' to more 'gradualist' or 'industrialist' oriented bureaucrats and from those who were opposed to foreign investment to those who had advocated it in the earlier periods of transformation.

It should be noted that the internally oriented path of building national capitalism was not the only strategy discussed among Czech policy makers. As noted in the section on Czechoslovakia, beginning in the early 1990s there were voices arguing that openness to foreign direct investment was a desirable option since it would help the modernization of enterprises and it would provide some much-needed managerial know-how. At the time, however, any initiatives to rely more on foreign investment during privatization typically came from individual bureaucrats or experts, rather than being part of programs of political parties. Nevertheless, they were still considered as an opposition to the main governmental program of nationally oriented privatization. Hence, from the very beginning the advocates in favour of foreign investment in the Czech Republic represented the opposition to the neoliberal agenda, rather than being part of it. The following section will outline the main feature of this minority position and its gradual strengthening during the course of the crisis of national capitalism formation.

Foreign investment in hostile times

Foreign investment in the early- and mid-1990s remained fairly low and appeared mostly in the form of portfolio investment – until investors learned that they were not at all protected in the Czech stock market. Foreign direct investment was even lower - several important deals were concluded before Czech independence, but much less so after Prime Minister Klaus and Ježek, the Minister of Privatization and later head of National Property Fund, took control over the privatization process. Direct sales to foreigners, which were in theory possible during the Czechoslovakian federation under an informal agreement between Klaus and Vrba, were in practice opposed by some within the management of Czech enterprises, as well as by the political advocates of voucher model. An example is the Tatra truck production plant, which was initially earmarked for sale to foreigners at the behest of Jan Vrba. However, the management, fearful for their positions after foreign owners had taken over argued, that the foreigners would turn Tatra into an assembly plant and favoured voucher privatization instead. This met with the full support of the government, who themselves wanted the famous Tatra enterprise to demonstrate the success of the voucher privatization (Myant, 2003: 177). Similarly, ČKD was also in negotiations with Daimler Benz over establishing a joint venture in 1991, with the German producer showing interest in the entire combine, initially, and later on only in tram producing division. However, as the deal was not closed by 1993, the new government withdrew from the negotiations and turned to domestic solutions. As early as January 1990 the management of Škoda Plzen was already talking to major foreign firms interested in a joint venture: including General Electric, the Swiss-Swedish combine ABB, as well Siemens – whose offer the government and the management found most suitable. However, after the management threatened to close the firm due to unpaid state railways bills, a local entrepreneur Soudek approached Klaus and – after one single meeting – an agreement was struck whereby the state would sell him a 34% share in the company and nominate him to the post of general director. The deal was eventually different, with two state banks involved in buying part of the shares, but Soudek did become a director and soon announced that there was no need for Siemens to become a partner since 'Czech is just as capable as a German' (quoted in Myant, 2003: 217).

Thus, part of the opposition to the externally oriented strategies came from a coalition of interests consisting of nationally oriented neoliberals in the Czech government and the managers of domestic industrial enterprises. It is true, as Appel argues (2004), that managers did not have the upper hand in the process of privatization and they certainly had much less influence than their Slovakian counterparts, for instance. Although managers could not secure advantages for themselves as a group by privileging management buyout schemes, for instance, they were still able to acquire large shares of enterprises through the voucher privatizations. Most importantly, however, they were allied with the government in opposition against foreign investment. The small FDI-oriented group of industrialists in the government thus had no chance of pushing its program through – not only was the public quite hostile towards the idea of Czech industry being sold to foreigners, especially fearing a German takeover, but in individual privatization cases management was also in favour of voucher privatization.

Still, the compromise between Klaus and Vrba that took place already during the Czechoslovakian federation era left its imprint on Czech policy not only through the agreed acquisitions of selected enterprises by foreign investors, but also through the existing institutional infrastructure. CzechInvest, which was founded as early as 1991, continued working in this period. The main inspiration for the establishment of the agency came from a PHARE financed Irish advisor to the Ministry of Industry and Trade and, upon deciding on the establishment of the Agency, the Minister Vladimir Dlouhy invited Jan Havelka to lead the agency. Havelka, who was at the time Slovak Deputy Minister for Foreign Affaris and as such was responsible for the establishment of the Slovak investment promotion agency, SNAZIR, accepted the offer after learning that he was blacklisted by Meciar and had no chance of returning to the public service in Slovakia (Havelka, interview). The environment was, however, fairly hostile for CzechInvest as the government was not supportive of foreign investment at the time – especially ODS and the circle around Vaclav Klaus. Nationalism was not the only source of animosity between the charismatic prime minister and the agency – Klaus was also strongly devoted to liberal economics and the belief that everything should be solved by the invisible hand of the market: an agency like CzechInvest would have no role to play in such a system (Havelka, interview). Still, the agency was not abolished and it managed to function much more successfully than its Slovak counterpart, thanks in part to the support of officials in the Ministry of Industry and Trade, in particular the Deputy Minister Vaclav Petricek who had been a Deputy Minister in the Czechoslovak Federal Ministry and was a close associate of Jan Vrba. Another reason was the financial support from the EU pre-accession funds, with PHARE providing more than half of the agency's total budget in the 1990s (Drahokoupil, 2009). PHARE was also the main source of financing for CzechInvest's foreign offices, which played an important role in attracting foreign investors to the country. In trying to win support for foreign involvement in economic restructuring, the agency focused primarily on attracting the investment in manufacturing as these were particularly suitable for creating jobs for the Czech labour force, as well as for the transfer of technology. Being relatively independent from the Ministry of Industry, the agency also consistently lobbied for the adoption of investment incentives as the best way to attract foreign investment. The government continued to firmly oppose granting investment incentives, a position which naturally stemmed from their negative attitude towards foreign investment and an activist industrial policy in the first place. As the CEO of CzechInvest at the time, Jan Havelka, recalls: *We repeatedly showed them the cases where we have lost very important investors like GM, Intel... because simply we were not competitive enough. And I told them: look, personally, I would be quite happy if there were no incentives in whole of Europe or the world, but looking at all the attempts to do that in OECD or in WTO which quickly failed because even the countries which were officially transparent, liberal, open market economy, were granting such things. So we repeatedly told them that we are in a competitive situation. Either we will follow and try to be competitive or we can simply forget about foreign investment. Which was actually the political opinion of the leader of coalition ODS.* (Havelka, interview).

The success of the agency was not apparent in the amounts of FDI coming into the Czech Republic at the time – these remained fairly low throughout the 1990s. Its success was primarily in its survival and the creation of both an ideational and an institutional platform that would later represent an important part of the Czech Competition State. The main approach of the agency was certainly investment attraction through targeted incentives and direct negotiations with investors, rather than simply cutting taxes. Once the tide changed and the political and economic elites acknowledged the necessity of opening the economy to FDI, it was the institutional and intellectual position of CzechInvest that became the basis for the development of a strategy on *how* to attract FDI. However, contrary to the common views associating FDI attraction with the neoliberal program, the strategy centered on CzechInvest became part of the Social Democrats' program rather than that of the neoliberals.

Welfare state pragmatism – retaining the Czech welfare state

As stated above, the partial neoliberal economic transformation was accompanied by the establishment of the 'welfarist social contract', although without granting trade unions a more stable role in policy making (Bohle and Greskovits, 2012: 152). The inauguration of a neoliberal government did not mean that the 'emergency welfare state' set up in Czechoslovakia after the Velvet Revolustion was quickly dismantled. Rather, the system of social protection (as well as maintaining employment) was kept in place as a means to prevent social dislocation and a backlash against the reforms. Rhetorically, however, Klaus was a stark opponent of the welfare state, while from the very beginning the oppositional Social Democrats embraced the welfare state so that concern with 'social issues' and the welfare state remained an important dimension of differentiation in Czech party politics. The setting up of the emergency welfare state also meant that, to the extent that its contours and the overall welfarist social contract were to be dismantled later on, it would have to come about as the result of profound shifts in politics and the moving of political focus onto regime or identity issues, rather than socio-economic ones. In the Czech Republic, however, this never happened and the public provision of social protection was never subject to such harsh attacks as were seen in Slovakia.

Despite the neoliberal rhetoric and the emphasis on individual responsibility and market-mechanisms of allocating resources, the ODS government was certainly not on a mission to dismantle the welfare state. The social safety net established during the Czechoslovakian federation era, which relied greatly on the institutions of the socialist and pre-socialist welfare state, was by and large kept in place. Yet, far from being the matter of programmatic proclamation of the government, the welfare state was rather preserved as the means of avoiding a potential social backlash against the neoliberal reforms. In the words of the then Deputy Minister for Labour and Social Affairs, Igor Tomes: '*Klaus was against all the moves and there was always a tremendous tension between Miller (Minister of Labour) and Klaus. And very many of these tensions ended up in Klaus´ office. There was a tremendous fight for every step we had to do because Klaus was against everything. He had only one agenda: liberalization, privatization and nothing else. The fact is that when he started privatizing, he invited me to participate in his team and to do the social supplement of his liberalization reforms. That is true, he invited me, but it was us who offered the solution. He had no social feeling, he only had the information from Brazil and Indonesia that something has to be done, otherwise the people will revolt.* (Tomes, interview).

Still, the government certainly departed from a more corporatist and pluralist management of welfare envisaged by the early architects of the resurrected Czech welfare state. While the initial social policy reformers wanted, for instance, to create a separate social insurance agency managed in a corporatist manner, the government actually kept the pensions in the state budget.

Furthermore, some cutting measures were still implemented. Thus, in April 1993 children's allowances were eliminated for families with one child whose incomes were two or more times greater than the minimum living standard, while the basis for the payment of children's allowances changed from the number of children in the family to the age of the children. In 1995, the criteria for children's allowances were again tightened by limiting them to families with income no greater than 1.8 times the minimum living standard (Rueschmeyer and Wolchik, 1999). Unemployment benefits were also cut and, in 1992, capped at 1.5 times the minimum wage, thus substantially reducing the earlier replacement rates. Benefits were further cut by the caretaker Tosovsky government in 1998 which reduced replacement rates by 10% thus setting them at 50% for the first month and 40% for the next three months spent in receipt of benefits (Saxonberg and Sirovatka, 2009). At the same time, the government introduced the means-tested social assistance scheme, with benefits calculated on the basis of the living minimum.

As for the pensions, they were actually increased altogether six times between 1990 and 1994 in order to offset the increase in the cost of living. Still, the Klaus government did implement parametric reforms – gradually increasing the retirement age to 61 for women and 62 for men as well as tightening the conditions for receiving disability pensions. Reforms were passed in 1995 and 1996 that, in addition to raising the retirement age, also introduced two tiers in pension benefits: flat-rate basic benefit and the benefit which depends on the years and level of contributions. Although the reform introduced more differentiation and stronger linking of pensions with previous earnings, the system was still basically redistributive in character. The reforms met with resistance from trade unions, especially with respect to increasing the retirement age, with unions staging the biggest protests since 1989 (Lesay, 2009). Nevertheless, the reform was still passed, albeit with compensation in the form of provisions increasing the level of temporary early retirement benefits. Attempts were also made to remove pension funds from the rest of the state budget, but the only change actually made came in 1996 when a special account within the state budget was introduced in order to record the difference between pension revenues and expenditures. As the initial data showed a surplus on the pension account, the contribution rate was reduced from 27% to 26% in 1996 thereby eliminating the surplus after 1998. In 1994 the government also introduced a new system of supplementary pensions that relied on individual contributions with no required matching funds from employers and with no defined benefits – basically, employees could contribute to a private fund and then withdraw their savings upon retirement (Lesay, 2009).

As for the fiscal policy, in line with the neoliberal worldview of the dominant party, the government pursued a policy of balancing the budget. In January 1993 a completely new tax system was introduced, with the introduction of five brackets of personal income tax with a top rate of 40%, as well as the introduction of VAT designed with the view to future EU accession, excise duties, real estate tax, road tax and other minor taxes. Following the logic of reducing the state share and role in the economy, an explicit fiscal target of no increase in the nominal state debt (implying a decrease as a share of GDP) was set. The government even proposed a law that would have imposed an obligation for the government to keep the budget balanced, but it was not adopted in the parliament. Total fiscal revenue as a share of GDP thus fell from 43% in

1993 to 38% in 1998. This was primarily due to cuts in corporate income taxes, with statutory corporate tax rate being reduced from 45% to 42% in 1994 and further to 35% by 1998, with the share of corporate tax in total taxation falling from 16.5 to 9.7% (Appel, 2006). On the other hand, the share of personal income tax in total taxation increased from 8.9 to 13.6%, while the share of social contributions rose from 38.6 to 44% of total fiscal revenue, or 17% of GDP. The latter was due primarily to cuts in other taxes, while leaving social contributions untouched. (Pellegrino, 2004). The short lived tax holidays from the early 1990s were, however, cancelled by Klaus. VAT was also cut from 23% to 22%, while the list of goods taxed under the reduced rate expanded, thus leading to a drop in VAT revenues from 15.4% of GDP in 1993 to 12.4% in 1998. The combination of the liberal ideal of a small state combined with the re-establishment of the pre-communist insurance-based welfare state thus created a very specific tax mix.

Overall thus, despite its declared neoliberalism, the ODS government actually preserved the emergency welfare state established after the collapse of socialism and inspired by the social democratic and Bismarckian elements of the pre-socialist Czech social insurance institutions. Nevertheless, from the very beginning this welfare state was far from institutionalized decommodification, especially when came to policies for the unemployed, and it was geared more towards providing income protection for the elderly than for the working-age population towards which the government implemented a more low-wage and low-unemployment strategy (Keune, 2006). Furthermore, even in its fiscal policy, despite adhering to the principle of a balanced budget and the reductions of corporate tax rates, the progressivity of personal income tax was still maintained. Thus, Czech fiscal neoliberalism was still far from the radical neoliberal experiments implemented in the Baltic republics. Similar to its Slovakian counterpart in the early and mid-1990s, the Czech welfare state also served as a crucial element providing social protection and compensation for market liberalization and helping to secure the support for the economic reforms.

Democratization and party system development in the Czech Republic

Among all East European political party systems, from the very beginning of democratization the Czech system has been described as the one most closely resembling the West European party systems with a socio-economic left–right cleavage constituting the main axis of competition among political parties. After the split of the Civic Forum umbrella movement, the crystallization of political parties and their differentiation from each other proceeded mainly along the lines of a debate over the process of economic reforms, as well as the stance towards the welfare state. Following Kitchelt et. al. (1999), this development can largely be attributed to the political legacy of socialism. In particular, according to Kitschelt et. al., three different types of socialism affect the development of programmatic party competition in different ways. While bureaucratic-authoritarian socialism fosters the development of post-socialist party systems based on programmatic competition – basically, socio-economic left-right issues – the legacy of national-accommodative or patrimonial socialism is less conducive for such a development and is more likely to lead to the clientelistic or personalistic competition among political parties. While the legacy of bureaucratic-authoritarian socialism certainly helped the initial politicization of economic reforms and the formation of a party system along the axis of socio-economic cleavage, the effects of this legacy are, however, still amenable to change to the extent that the resolutions of the multiple dilemmas of simultaneous political and economic transformation lead to the repoliticization of identity or political regime issues. This is where – and especially in comparison with Slovakia - the Czech model of privatization becomes important not only from the economic, but also from the political point of view.

As stated above, the Czech privatization model was basically the continuation of policies adopted already during Czechoslovakia. What is important here is that during the process of national capitalism building, thanks in part to the outsider-oriented privatization, the Czech Republic saw no major breaches of basic democratic procedures and, on the contrary, witnessed the consolidation of both its liberal democracy and its political party system. Voucher privatization, which at least initially attempted to reward almost everyone, actually reduced the intensity of distributional conflict and created a democratic consensus supporting the broad outlines of the privatization program. More importantly, it also created rival and crosscutting interest groups that fought for control over economic policy and that did not clearly fall into one or another political camp. The debate over capital market regulation, for instance, developed largely *among* ODS associates, despite the clear support of the CSSD for more market regulation (Gould, 2011). In other words, the winners of the partial reforms in the Czech case – managers of privatized companies, small shareholders - did not have a clear cut political ally that would have to remain in power in order for them to continue benefiting from the partial reform equilibrium. Nor did the oppositional CSSD propose any other types of privatization, meaning that the cost to the ruling party of losing elections was much lower in the case of the Czech national capitalism winners than was the case in Slovakia.

The combination of a relatively benign privatization method (benign in the political, not the economic sense!) and the favourable legacy of bureaucratic-authoritarian socialism thus created the preconditions for the Czech political and party system to develop largely on the basis of disagreements on socio-economic left-right issues. While fully acknowledging Kitschelt's thesis of the interplay of legacies and democratic institutions as the determining factors shaping the emergence of the new post-socialist party systems, the argument here is that the features of these party systems may change in the course of the systemic economic reforms and the process of capitalism building implemented by individual countries. Thus, while the political legacy of bureaucratic-authoritarian socialism created some initial conditions favourable for the development of a party system focused on socio-economic issue divides, it was the subsequent resolution of the dilemmas of simultaneous political and economic transformation (Offe, 1991) that made the difference for the development of Czech and Slovak political systems. More precisely, it was the implementation of the privatization process in Slovakia which jeopardized the very existence of its democracy and pushed the party system to structure itself around the choice between democratization and political liberalism or authoritarianism, rather than socio-economic conflicts. It is true that Kitschelt et. al. (1999) consider Slovakia to be a borderline case closer to patrimonial communism, with similarities to cases where the regime change took place through pre-emptive reforms rather than through mobilization from below. Nevertheless, the relevance of this legacy became apparent only after Slovakia had already split from the Czech Republic; i.e. after the divisions on economic reforms became transformed into differences over the functioning of the Federation, rather than having nationalist issues taking central stage from the very beginning of the transformation. Furthermore, as the authors themselves note, legacies are the strongest factor at the beginning of the post-communist democratization since institutions and political-economic reform strategies tend to be endogenous to legacies at that time or because actors have not yet learned to take advantage of the new arrangements, while the independent causal efficacy of institutions and new political-economic relations are only likely to assert themselves gradually (Kitschelt et.al., 1999). Over time, indeed, the new political-economic constellation created by the process of building capitalism (in which the key pillar is privatization policy) begins to have its own independent effect on further political developments.

In the Czech case, the effect of privatization on national politics and democratization was a relatively benign one. More precisely, given the wide and cross-cutting distribution of winners, and given the involvement of the oppositional parties within the process, the basic contours of the system were not actually questioned and consequently Czech politics remained focused on the third-order legitimacy issues (Easton, 1957), or what Bohle and Greskovits (2012) call the dominantly materialist political arena. The main divisions in the political system were thus to be found in the realm of (non-systemic) economic reforms – i.e. *how* to privatize, rather than *whether* to privatize or not - the role of the state in managing economic transformation, the role of trade unions in policy making as well as the generosity of the welfare state. As Kitschelt et. al. (1999) plausibly argue, there are three main reasons why economic divides become predominant in polities emerging from the ruins of bureaucratic-authoritarian communism: the weakness of the un-reformed communist party leaves more room for alternative political programs, such as social-democrats or market liberals; the class structure developed in the pre-communist industrialization with highly-skilled labour and professionals creates *demand* for market liberal parties, while the simultaneous existence of orthodox-Marxist poles allows new political entrepreneurs to engage in strategies of 'programmatic product differentiation' leading to the 'left' and 'right' being identified primarily with economic policy alternatives; third, the socio-cultural divide is weakened by the legacies of early industrialization and secularization and the weakened position of the Catholic Church (Kitschelt et.al., 1999). The above conditions fit the Czech case perfectly – moreover the Czech Republic maintained the institutions of closed list proportional representation and a weak presidency thus endorsing institutions that favoured programmatic rather than personalized political competition.

After the split of the Federation, the main parties of the Czech system included a weak and marginalized Communist successor party (KSCM), the market liberal ODS and the social democratic CSSD. Since KSCM lacked any innovative leadership that could adapt to the democratic environment, the main beneficiary of the growing discontent with the liberal economic reforms was the CSSD who endorsed liberal political institutions and market liberalism but combined with social protection. More precisely, they were not exactly advocating market liberalism – rather they *were* advocating market economy, but one with much more social democratic and state-interventionist overtones. On the other hand, despite its pragmatic policy stance and only partial neoliberalism in practice, ODS was a proponent of strongly market liberal policies at the discursive level. The result was that programmatic crystallization on economic issues was quite pronounced in the Czech Republic - much more so than in Poland or Hungary, for instance; not to mention cases like Bulgaria and Romania - and that economic protectionism vs. market liberalism indeed was *the* main divide structuring the Czech party system (Kitschelt, 1999).

This programmatic crystallization and conflict among the main Czech political parties thus referred primarily to a number of economic and social policies while the socio-economic left-right divisions were widely understood to be the main axis of party system structuring in the Czech Republic (Vlachova, 1997). Moreover, this crystallization also appears to have taken place among the electorate in the early years of Czech democratization, with citizens identifying themselves with the left political pole developing more egalitarian views, and those identifying themselves as being on the right developing more anti-egalitarian attitudes over time. Furthermore, the class-party association strengthened between 1992 and 1996 so that the class-based political programs of the parties seem to be the main drivers of voting behaviour, rather than the personalities of Zeman and Klaus (Mateju and Rehakova, 1997).

In terms of industrial policy for instance, ODS was in favour of stark market liberalism and Klaus declared himself to be 'a stronger opponent of industrial policy than anybody in the world… Industrial policy is impossible. It is incorrect and irrational. I know how hopeless it is to sit down in my office to decide anything about any industry. It is wrong *a priori*.' (quoted in Dangerfield, 1997: 447). The CSSD, on the other hand, advocated a more activist industrial policy and government support for industry as the only way to increase competitiveness and reduce the widening trade deficit. Similarly, ODS focused on maintaining a balanced state budget with Klaus even proposing to pass a law in August 1994 that would have made it illegal for any government to set a budget that was not balanced. The CSSD leader Milos Zeman, a convinced Keynesian, suggested in turn that the proposal should be referred to an 'economic psychiatrist' (Dangerfield, 1997: 448). Similarly, when it came to social policies, the government was rhetorically opposed to any idea of a strong welfare state with Klaus arguing against state paternalism, while the CSSD was much more in favour of it and often referred back to the traditional Czech Social Democratic legacy. Finally, trade unions' relations with the government and public workers' protests in 1995 and 1996 led the unions to develop a stronger alliance with the CSSD thus further exacerbating the divisions between the anti-unionist ODS and the CSSD.

The consequence of this clear left-right differentiation was that the programmatic competition led to the emergence of *different* political programs and different ideas on what constitutes economic development and what kind of economic and social policies the country should be pursuing. In other words, politics was not simply about whether harsh economic reforms that 'we all know are necessary' should be watered down with some social safety net; rather they were about different concept of what constitutes an appropriate economic reform that would generate economic growth and to what extent the welfare state is an undesirable burden or a demand-fostering stabilization mechanism. This type of political system had two consequences: first, since material concerns were the bread and butter of politics, even the starkest neoliberals *had* to preserve some kind of welfare state since they were afraid that the rapid deterioration of material conditions would cost them a great part of political support; and second, once the Czech-style national capitalism regime exhausted itself, political parties came up with different and competing agendas and different views on what strategies exactly should be implemented in order to achieve economic recovery and growth through transnational capitalism building.

What is also important is that, thanks to the existence of a non-reformed Communist party and the fact that the Social Democrats came from among the dissidents' groups rather than the old party, Czech actors on the left side of the political spectrum did not have to prove their credentials and their adherence to the principles of the market economy. In contrast with their Polish and Hungarian counterparts – post-communist left-wing parties – they thus had more space to advocate market-friendly but still quite socially generous social policies.

The development of the Czech political system is thus well captured by Bohle and Greskovits' (2012) concept of 'materialist politics' – in the words of the political systems theory, it was a system in which the main source of legitimacy for political parties were third-order issues related to redistributive 'who gets what' questions rather than identity or political regime questions (Easton, 1957; Offe, 1991). The socio-economic cleavage formed in these years remained the main source of political conflict and political party identification in the years to come and, as opposed to the more complicated developments in Slovakia, democratization or identity questions never made it to the core of Czech politics. Consequently, the shift from national to transnational capitalism generated another transformation on the part of political parties, leading them to adopt transnationalised but *different* economic agendas.

The fall of Czech capitalism

The lack of enterprise restructuring in an open economy, the accumulation of non-performing loans and the widespread practice of asset-stripping finally led to a recession in 1996-1997. The deteriorating trade balance associated with low levels of enterprise restructuring led to the current account deficit reaching 8.3% of GDP in the first quarter of 1997. Pressed by the rising 'nervousness' in the currency markets, the government accepted the IMF advice and adopted two austerity packages in spring 1997, including cuts to the welfare state and the introduction of targeting in family allowances. In May 1997, the Czech crown experienced a speculative attack and the National Bank was forced to float the national currency. Furthermore, after finally implementing bank regulations requiring the full disclosure of loans, thereby exposing the proportion of non-performing loans on financial institutions' balance sheets, a credit crunch ensued and several banks went bankrupt. This situation left enterprises with no source of capital and made them look at foreign capital as the only possible solution. Gradually, a consensus emerged among the political, as well as the expert, community that the Czech capitalism was showing major weaknesses and that the only way out was to turn to foreign investment. Even ODS and Klaus himself eventually accepted the necessity of bringing in foreign investors and the government started to prepare the system of investment incentives. As Jan Havelka put it: '*In the misery that started to be quite visible, Klaus finally accepted the fact that sooner or later we will need some kind of financial injection. And the most transparent and the best way was to open the doors, start to be competitive on the international market of FDI and in autumn of 1997 in the meeting of Economic Ministers in the government, Klaus accepted our proposal to start to think and prepare the system of incentives. It was his decision. He said to me that he is doing that with internal, deep opposition towards it, but because most of the ministers voted for that, he would accept it. Actually, voting was more or less prepared before that, but he wanted to save face.*' (Havelka, interview).

The need to re-think the Czech way was further exacerbated by the political crisis caused by the revelation of corruption scandals during privatization as well as the disclosure of secret bank accounts and party funding associated with privatization deals. The amount of corruption in the Czech privatization was indeed substantial, however throughout the 1990s the government was successful in representing corruption cases as deviations and isolated incidents in an otherwise clear, transparent and fair privatization process (Appel, 2001). Thanks to the voucher privatization model in which every citizen had the right to participate, this was indeed a feasible strategy. (The Slovak government on the other hand, with its method of direct sales to political protégées, did not have this opportunity.) Hence, it was only when the economic situation worsened that corruption and criticism of the privatization process became an issue of major public concern – eventually leading to the breakup of the governing coalition and the establishment of the caretaker government headed by the former Central Bank governor Jozef Tosovsky. The new government scheduled elections for May 1998. However, the results of the elections, with the right-wing parties again winning the majority of the seats, showed that the public was obviously not keen on punishing the incumbents for the scandals (Appel, 2001). Rather, it seemed that certain personal animosities amongst the previous coalition partners led to a situation where the party forming the government turned out to be CSSD. Furthermore, the market liberal Freedom Party rejected the idea of a coalition with CSSD on the basis of ideological differences related to socio-economic policies. Thus, coalition building in the Czech Republic in late 1990s remained shaped by left-right political divisions – which, as we will see, is again in contrast with Slovakia where the failure of national capitalism triggered politics revolving around political regime issues and led to a government formed by ideologically diverse coalitions or parties united primarily by their opposition to the semi-authoritarian regime of Vladimir Meciar.

Conclusion

The examination of the Czech attempt at building national capitalism shows that it was indeed a combination of its own inherent weaknesses and the pressures of transnational market integration that led the political elite to shift from internally-oriented national capitalism building to an externally-oriented strategy of attracting FDI and managing economic transnationalisation. The fact that a consensus on reorienting towards FDI appeared across the political spectrum, as well as that it was triggered primarily by an economic and currency crisis, shows that the shift from inward-oriented to externally-oriented strategies and the emergence of the Competition state is indeed primarily the result of the exposure of the country to the pressures of the international markets and, in particular, international financial markets. While specific economic weaknesses and the deteriorating terms of trade could have been apparent in other peripheral European countries, such as the South European ones, it was their membership in the EMU that prevented the emergence of the kind of crisis that the Czech Republic experienced in the late 1990s. Nevertheless, while the shift towards the development of a Competition State may have been triggered by the crisis of Czech national capitalism, the response to this crisis was still not predetermined by the structural pressures of the global markets. Rather, thanks to the particular structure of the Czech political party system focused predominantly on the conflict over socio-economic left-right issues, responses to the crisis and the particular strategies for attracting FDI and increasing competitiveness became a matter of fierce conflict among Czech political parties. Consequently, it was this politicization of strategies for increasing competitiveness that fostered the emergence of a particular high-road type of Competition State in the Czech Republic.

Managing transnationalisation – the emergence of the high-road Competition State

Introduction

The Czech social democratic Competition State emerged as a response to the crisis of the late 1990s, when it became clear that the Czech model of national capitalism had ran its course and that radical changes in economic strategy are necessary. However, in contrast to Slovakia, the crisis of Czech national capitalism was a purely economic crisis rather than one encompassing the political regime and, as a result, the economic strategies that were developed in response to it became the crux of competition among political parties. Both left and right parties saw the main problem as being the dearth of investment (particularly salient following the banking crash) coupled with the lack of industrial modernization and competitiveness so, after the complete failure of the incumbent Czech owners and managers, all parties set out to attract foreign investors that would provide technological upgrading and managerial know-how. Still, despite the consensus on externally oriented strategies, there still remained conflict among parties as to how exactly foreign investment should be managed, as well the implications it would have for other governmental policies. While ODS was advocating lower taxes and the introduction of a flat-tax as the best means to increase the attractiveness of country for foreign investment, CSSD was more oriented towards providing investment subsidies, infrastructure and an educated labour force. Furthermore, the social democrats' strategy of increasing competitiveness through technological upgrading and improving one's position in global value chains meant that labour costs were not considered a drag on competitiveness – nor was the welfare state seen as a problem for economic growth as long as it was not based on simply giving out subsidies to the unemployed, but rather focused on retraining and education.

In contrast with Slovakia, thus, the crisis of national capitalism triggered *different* economic ideas as to how it should be resolved, with competitiveness and FDI attraction appearing as part of very different programs. This choice ranged from a 'cheap' and non-interfering state to one pursuing 'active industrial policies' and was reflected in either a completely privatized or a largely public provision of welfare. As opposed to Slovakia then, the Czech Republic saw the appearance of not only a neoliberal, but also a social democratic, competitiveness agenda - and not merely as a discursive construction but even as a set of policies that were subsequently put in place. Furthermore, as discussed in the previous section, thanks to the neoliberal strategy of building national capitalism in the Czech Republic, FDI attraction was part of the political opposition to neoliberalism, rather than a clear-cut neoliberal agenda. It is true that, by the end of the 1990s, even the previously neoliberal economic nationalists had turned to external solutions but, far from making neoliberalism the hegemonic paradigm of economic transnationalisation, it was challenged by the social democratic transnationalisation agenda which was the one that came to be implemented after the elections.

The following section will thus provide an account of the main features of the Czech Competition State and the key debates through which it evolved. It will be demonstrated that the set of policies put in place by Social Democrats was part of a coherent political program based on a particular idea of competitiveness that is certainly far from traditional post-War Golden Age Social Democracy, but that is also not exactly the same as the minimalist neoliberal political program. The overarching idea of quality competitiveness can then be traced in the investment promotion policies and the strengthening of the position of CzechInvest. Similarly, we can pick up on this element in the debates on welfare reform, in which the push for radical privatization as a means of increasing competitiveness and modernizing the social system was completely absent on the social democratic side of the political spectrum, where the emphasis was much more on increasing education expenditures. It is true that this program was challenged both from the right side of the political spectrum, as well as from inside CSSD itself; however the evidence shows that its supporters were still strong enough to prevent the Czech Republic from sliding towards the clear-cut neoliberal road. Furthermore, once different ideas about competitiveness appeared among Social Democrats' lines, an important factor pushing the party against the minimalist, low-road strategy for increasing competitiveness was precisely the need to differentiate its program from that of its main political opponent, ODS. Hence, the fact that the political party system was structured predominantly on the basis of different economic strategies helped sustain the distinct, high-road form of Competition State in the Czech Republic throughout the two governments led by Social Democrats.

Party politics in transnational capitalism

Similarly to in the period of national capitalism building, politics and party competition in the Czech Republic in the era of transnational capitalism continued to be marked by polarization based primarily on socio-economic issues. Indeed, from 1996 to 1998 the significance of the socio-economic cleavage continued to increase, both in terms of the differentiation of party programs as well as the identification and party preferences of the electorate. This trend actually continued in the 2000s, at least with respect to party programs with both CSSD and ODS primarily emphasizing their differences on the issues of taxation, pension reform and health reform (Hloušek and Kopeček, 2008). Contrary to the argument of Grzymala Busse in *East European Politics and Society* (2003), party politics in the years leading up to the accession to the EU and in the period of intense harmonization with the *acquis communitaire* did not become reduced solely to the question of who was better placed to administer the necessary reforms. Rather, there was quite some disagreement over what kinds of reforms should be instigated in the first place and what strategies for building transnational capitalism and increasing competitiveness the country should implement.

To begin with, two different ideas about what constitutes competitiveness and how it is best achieved appeared in the Czech Republic – and, by and large, they corresponded with the distinctions found in the literature between 'cost competitiveness' vs. 'quality competitiveness' (Hay, 2012: 1) or 'performing competitiveness' vs. 'underlying competitiveness' (Pfaller et.al., 1991: 5-11). While both of these views certainly put increasing competitiveness at the top of the policy agenda, they differ in the treatment of competitiveness as such, as well as in their ideas of which reforms constitute the best way to increase competitiveness. As argued in the previous chapters, one was based on New Growth economic theories, according to which the state still actively helps the supply of capital by providing infrastructure and an educated labour force. Furthermore, the state was perceived as playing an important role not only in attracting FDI but also in influencing the type of FDI that came by striving to attract investments that would bring higher-value-added activities into the country. The other strategy was based on neoclassical theories, according to which the state simply offers a low and neutral tax environment, reduces non-wage labour costs and administrative burdens on businesses, while decisions on the type of investments made and the activities relocated to the country are left entirely to the investors.

These different economic ideas can be easily identified in the political parties' programs and policy proposals and, moreover, they also constituted a core dimension over which the conflict in the political arena was fought. While the Social Democrats embraced investment incentives adopted by the Tosovsky technical government, and even proposed to increase them if they had won the elections, ODS criticized them by arguing that there was no need for an activist industrial policy. CSSD, on the other hand, strongly rejected the minimalist concept of the state adopted by the previous government as "based on the unsustainable concept of the 'weak state', knowing nothing and responsible for nothing" (Volebny Program CSSD, 1998). Human capital spending certainly figured among the primary concerns of this activist state: '*the qualifications of* *people are currently becoming a basic production factor. Only a society which is capable of making an investment into the lifelong education of its citizens, and in this respect in the development of their skills, will be able to achieve long term success in international competition… Social spending, investment into human capital or into the development of the human potential is considered by the Government to be the most effective form of Government investment*' (Policy Statement of the Government of the Czech Republic, 1998: 1). Furthermore, CSSD advocated the preservation of the welfare state – or more precisely, a generous but recommodifying workfare state – on the grounds that it does *not* hinder competitiveness since they do not want to compete on the basis of low wages, but rather aimed to challenge for the higher-value-added parts of production chain: '*The Government rejects the idea that it is cheap labour which could become our basic comparative advantage in the world competition of the globalized society. On the contrary, it holds the view that we should be able to break through by the effective utilization of qualified and well-paid labour with high productivity.*' (Policy Statement of the Government of the Czech Republic, 1998: 1-2).

ODS, for their part, advocated radical liberalization since only markets should distribute goods: '*The idea of cheap and small state in our country today is on the defensive. Leftist parties thrive by playing a populist chord and promising less independent citizens that the state will take care of them if they give the opportunity to the politicians of these parties. ODS is derived from the ancient human experience that the operations of the state are a bigger problem than all known ills of the market economy. ODS promotes clearly defined, but significantly reduced, state powers. It wants a strong operational state, when it comes to safety, the protection of rights and justice. We start therefore from five departments known from classical liberal era: foreign affairs, justice, defense and finance. We want to build on them. In all that lies beyond them, we require that decision making returns to the citizen himself to the maximum extent possible. (…) A route to an efficient and cheaper state is, inter alia, by limiting the scope of state funds redistributed, slimming down the state administration and all other offices, simplifying the overly complex and incomprehensible legal system, reducing the sphere of state-controlled and controlled activities, reducing the overall tax burden on citizens, the privatization of state assets and increasing the expertise and professionalism of civil servants.*' (Ctyri Podebradske Artikuli, 1998). Consequently, ODS advocated a reduced tax burden, as well as the implementation of a flat-tax as the most simple and least interfering type of taxation. Furthermore, it also strongly argued for the individualization of social insurance as a tool to increase individual responsibility and reduce citizens' dependency on the state, as well as to reduce the costs of doing business in the country: '*Today we see the need to motivate everyone to create an insurance deposit for their own future. We are convinced that the way to do this is an appropriate level of individualization insurance systems. It is the only way to put an end to general irresponsibility and the consequent burdening of the responsible with the irresponsible* *ones. (…) Unlike other political parties, we are against extending compulsory insurance, especially on the part of employers on order not to endanger their costs and competitiveness.*' (Ctyri Podebradske Artikuly, 1998).

In contrast with the parallel developments in Slovakia, in the Czech Republic the neoliberal agenda of a small and low-cost state being the best way to attract investments and increase competitiveness was thus offered as only *one* among several different programs and strategies to increase competitiveness and it was electorally challenged by the Social Democrats' activist approach to investment attraction. Furthermore, as the Social Democrats' idea of competitiveness promised both high wages and higher public spending, as well as activist help to small and medium entrepreneurs (in addition to generous FDI incentives), it actually catered to the interests of different social groups. The election data show that between 1998 and 2002, as well as in the 2006 elections, the popularity of CSSD increased in particular among professionals and small and medium entrepreneurs, thus obviously extending far beyond the manual workers of the social-democrats' traditional constituency (Vecernik, 2009: 150-151).

Thus, contrary to those who view the Competition State and the race for investments as simply being an apolitical response to the pressures of globalization, the Czech case shows that strategies for increasing competitiveness and attracting FDI can actually become very politicized in a framework that fosters differentiation among parties on the basis of socio-economic left-right issues. At the same time, however, this differentiation is different than that described by the partisan literature on welfare state or partisan differences in supply-strategies, according to which Social Democrats were in charge of creating decommodifying welfare states (Esping-Andersen, 1990; Huber and Stephens 2001) or public investments based economic strategy (Boix, 1998). Rather, new Social Democrats seem to be focused more on active – as opposed to passive – *recommodification* in their social policy and a similarly active approach to fostering *private* investments in their economic policy.

Luring the investors – activist investment attraction in the Czech Republic

The transformation into a Competition State in Czech Republic had already started during the technical caretaker government of Josef Tosovsky and it was actually a continuation of the final decisions made by the ODS government. The most important steps included the development of an investment incentives scheme, the privatization of state owned banks and a revitalization programme for failing large enterprises. However, it was the Social Democratic party, which emerged as the victor of the 1998 elections, that implemented this program – and it was also the latter party that made the attraction of investment and the privatization of banks the key points of their economic strategy and the flagship of their election programme.

The decisions made by the caretaker government of Jozef Tosovsky regarding the introduction of the investment incentives scheme were soon politicized along the political party lines. Despite the fact that the ODS government had previously developed proposals for an incentive scheme as part of its crisis-measures, the scheme was publicly criticised by ODS officials such as the leader of ODS MPs, Vlastimil Tlusty. At the same time, the ODS electoral program focused on lowering taxes and introducing a flat tax as the key instruments in rendering the country more attractive to investors. On the other hand, Social Democrats praised the investment attraction scheme as part of their own election programme. Indeed, by that time a consensus was mounting whereby, given the dire economic crisis and the obvious failure of Czech capitalism, foreign capital and opening the country up to foreign investments was seen as the only solution. However, investment incentives *per se* certainly tallied more with the Social Democrat's strategy rather than the ODS's, as the economic experts who had drafted the industrial policy part of the CSSD electoral program had specifically focused on the benefits of incentives in achieving economic transformation and increasing competitiveness. In his article 'Keyword: investment', the then deputy Minister of Finance, Jan Mladek, argued that investment was the key aim of the CSSD government. This included both portfolio investment, which can be attracted only by regulating the financial markets and making sure that small shareholders do not get robbed as happened during Klaus' period, but primarily referred to direct investment capable of bringing modernization and know-how to Czech industry. In that respect, the CSSD plan was fully in agreement with the steps taken by the Tosovsky government, and the party leaders actually argued that state support should even be expanded and that it should include not only foreign investors, but also domestic ones. They also stated that the threshold of minimal investment eligible for state support should be lowered. The 1997 scheme proposed incentives only for investment above 25 million UDS – in comparison, Hungary was granting incentives for investment above 3 million USD. The high threshold set by the Tosovsky government was a result of the influence of people close to Klaus that continued to oppose the practice, and it was only with the Social Democratic government that the threshold was reduced to 10 million USD (Mladek, interview). This was, in fact, still too high for most domestic investors and 90% of state support was actually granted to foreign investors, but the biggest domestic ones could also benefit from the scheme.

The elections in 1998 actually returned a fairly even outcome – to everyone's surprise, Klaus and his ODS turned out to be far from politically dead. With only 74 of the 200 seats in parliament going to CSSD, it still had to seek a coalition partner or gain support for the minority government. As the Communist Party and ODS were not deemed suitable coalition partners and, as CSSD did not manage to form a majority coalition with other parties, an agreement was finally made between CSSD and ODS according to which CSSD formed a minority government. ODS supported the government in the parliament and, in return, it got the right to nominate several important political functionaries, including installing its leader Klaus as the speaker of the Parliament. This Opposition Agreement was, however, not the same as a Grand Coalition, and although CSSD could only form the government thanks to the support from ODS, this support did not actually require major policy concessions. According to Milos Zeman, the Prime Minister of the time, the Agreement actually stipulated only two major obligations for CSSD: they promised to reduce the budget deficit during their time in government and to introduce a change in the election law that would bring Czech Republic closer to the majoritarian system and thus benefit its biggest parties at the expense of the smaller ones. Interestingly enough, both of these goals were things that the CSSD leadership wanted to achieve anyways, so it turned out that the support of ODS was bought for a very low price (Zeman, interview). Still, opposition did have a say in many specific policy decisions, especially with regards to privatizations and the pension reforms (Mansfeldova, 2005).

The CSSD's economic policy was drafted by a group of economists who previously worked with Jan Vrba, the last federal Minister of Industry and the biggest advocate of foreign investment in the early 1990s. Hence, the ideas that were side-lined by Klaus and his neoliberal economists in the early 1990s now came to the fore with the change of government, where economists that could be described as 'industrialists' got prominent positions. While Mladek (deputy Minister of Finance), Mertlik (Minister of Finance) and Jiri Havel represent the experts that were always more open for foreign investment, Minister of Industry and Trade Miroslav Gregr still maintained more nationalist preferences. During the initial debates on privatization in the early 1990s, he advocated a model that would have given preferential treatment to domestic managers and later on, as the Minister of Industry in Zeman's government, he proposed a revitalization programme for failing enterprises that would give a prominent role to state-led restructuring rather than restructuring through foreign investment. (Myant, 2003). Nevertheless, he was certainly far from opposing FDI since, as early as 1991, he played an important role in Volkswagen's acquisition of Skoda when he was Minister of General and Electrical Engineering.

As the Minister of Industry from 1998 to 2002, he did often clash with other members of the government over the speed of foreign takeovers (e.g. the timing of the sales of the rest of the government's shares in Skoda to Volkswagen) or the restructuring strategy for failing enterprises. However, he was far from being a fierce opponent of FDI and during his mandate a number of investment deals were successfully concluded between the Ministry of Industry and foreign investors. Despite initially favouring a national developmental strategy that would not rely so much on FDI, after the failure of Klausian Czech capitalism which left Czech industry in dire state, Gregr himself saw no other alternative to relying on FDI.

In stark contrast with Slovakia, the government that brought about the Czech Competition State was not only open for foreign investment, which they saw as the main mechanism of modernizing the Czech economy and making it more competitive, it also had quite an industrialist outlook and was very far from neoclassical academic economists' mode of thinking. Mladek's articles on the solutions to the economic crisis in 1998 explicitly criticize macroeconomic fantasies and the social experiments of creating perfectly free markets attempted during Klaus government and instead advocated getting involved with the 'real' economy. However, saying that the government had an 'industrialist' rather than neoliberal approach does not mean that the Czech Competition State was simply the result of the influence of certain industry-related social groups – in the sense in which Crouch and Keune (2005), for example, identify the managers of internationalized socialist enterprises as the group behind the developmental strategy focused on FDI in Hungarian region of Gyor. The Czech competition state project certainly benefited specific social interests – most notably, foreign investors themselves, as well as the 'comprador service sector' (Drahokoupil, 2009: 114) including the army of consultants involved in preparing and assisting the investment projects – but these interests themselves seem to have largely materialized *afterwards*, while the state project was initially primarily pushed for by the state administration and backed by a specific political program. This administration was, however, fundamentally different from that crafting the Slovak competition state and it would certainly not correspond to anything that a reader associating the Competition State with a neoliberal project would expect. The Minister of Industry was a former manager of a forklift-truck manufacturer, rather than an academic economist dealing with neoclassical models of perfect and unfettered competition. Jan Havelka, the CEO of CzechInvest, was once a manager of the Czech tram producer, ČKD, while Prime Minister Zeman was an economist and 'prognostic' who worked in the Prognostics Institute, and describes himself as a faithful Keynesian rather than a follower of neoclassical beliefs (Zeman, interview). The economic experts (including the Minister of Finance, Pavel Mertlik and his

Deputy Minister, Mladek) were the close associates of Jan Vrba, the former Federal Minister of Industry who also came to that position after having been a manager of a textile enterprise. Vaclav Petricek, who was the Deputy Minister of Industry during the Klausian era and remained in that position after the change of government, used to work in the State Planning Commission during socialism. One could even point to the post-socialist neoliberals who used to be members of the Communist Party – however, at the time they were typically marginal economists consulting neoliberal literature, rather than managers of industrial enterprises and hence were more concerned with institutions emulating perfect market competition than the problems of the 'real economy'. Thus, while the Slovak Competition State was crafted precisely by such ex-communist neoliberals alongside very young economists educated in the US, the Czech Competition State was the project of engineers and former socialist managers whose view on the economy was a much more 'industrial' one.

The cornerstones of the economic policy of the CSSD government included investment incentives and strengthening the position of CzechInvest, the privatization of banks and the restructuring and revitalization of failing enterprises. Indeed, the lack of bank privatization was something that they sharply criticized while they were in opposition, using this issue also as a means to establish themselves as a leftist market supporter rather than merely the remnants from Communist times (Appel, 2004). At the same time, they also adopted a Keynesian approach towards fiscal and monetary policy, according to which in times of economic crisis the government would implement an expansionary policy regardless of any rise in public debt - and its increased spending was supposed to primarily take the form of investment in housing, infrastructure and education rather than consumption. Thus, they implemented an expansive fiscal policy, reducing taxes while at the same time increasing public expenditure. From the point of view of Competition State theories, however, an important question was of course what kind of taxes to cut. In line with their focus on fostering investment, the government cut corporate taxes in 2000 from 35% to 31%. Investment companies, investment funds and pension funds were taxed at a rate of 15%, but the government introduced changes in order to put them on the same level as other corporate income taxes from 2004 onwards. On the other hand, personal income tax was also reduced for the wealthiest taxpayers by abolishing the top tax bracket, but the overall progressivity of PIT was maintained with 4 instead of 5 tax brackets. The expansionary policy however led to an increase in the budget deficit: from 1.7% of GDP in 1996 to 2.7 in 1997, 2.8 in 1998, 4.0 in 1999, 7.5 in 2001 and 9% in 2002. While the government was increasing the share of revenues in GDP parallel with GDP growth, its public expenditure rose even faster thus leading to rapidly rising budget deficit. As the Prime Minister at the time, Milos Zeman, remarked, this was perfectly in line with the Keynesian theory as the country was recovering from the recession of the late 1990s and only in 2000 did it achieve positive GDP growth. (The Keynesian Zeman was, however, much more critical towards the continuing rise in the budget deficit during the term of his successor, Spidla, when the country was experiencing a small economic boom – Zeman, interview)

The first investment incentive scheme was implemented as a pilot project in 1998 during the caretaker Tosovsky government. The period of pilot projects ended in late 1999 and, in May 2000, a Law on investment incentives was declared which is, apart from some amendments, actually still in force today. At the same time, support for Czech suppliers was developed very early on with the Czech Supplier Development Programme started and administered by CzechInvest as early as 1999. With Zeman as the new Prime Minister, CzechInvest received great support from the government, while enjoying full independence in terms of its activities as well its staffing. As a result, CzechInvest was able to establish foreign offices, deemed very important for investment attraction, and organized numerous seminars and marketing activities – even receiving an award for being the best investment promotion agency in Europe in 2000. '*At the time we were highly appreciated, not only internationally, but also in domestic circles. In short, it was the 'Golden Age' of CzechInvest.'* (Havelka, interview).

Importantly, CzechInvest also continued to build an institutional platform for regular exchanges between policy makers, investors and the supporting service sector involved in investment attraction. In 1996 CzechInvest established the Association of Foreign Investors, an organization bringing together foreign investors, local consultancies and providers of business services as well as state bodies, with CzechInvest as the chair. Initially, the Association was established due to the conflict of interests that CzechInvest encountered when asked by foreign investors for advice on local services such as consultancies, law firms and the like. On the other hand, CzechInvest employees were also approached by some consultants seeking information on incoming investors with the aim of offering them business services. This all created an ethical dilemma as the agency officials did not want to favour certain firms over other, but they still wanted to provide investors with information and advice, not least because it was quite disadvantageous to have foreign investors cheated upon by local consultants, which did happen on some occasions. The idea of the AFI was inspired by West Virginia, where Havelka went on a study trip and learned about the practices of their investment promotion agency which established an association where local firms approved by the agency could join so that the agency could simply direct foreign investor in need of local services to the association (Havelka, interview). On the other hand, AFI also acted as a brains-trust for CzechInvest – since the association comprised lawyers, big auditing firms, tax advisors and the like, they would provide quick answers free of charge if CzechInvest had specific professional questions from potential investors. Over time, the Association also began to attract financing from big banks for important marketing and promotion operations, including events and awards such as the Investor of the Year, Industrial Zone of the Year, and so on – thereby lessening the burden on CzechInvest and the state. Furthermore, the Association also started to function as a communication channel between foreign investors and state officials with regards to a broader range of policies than simply the negotiations of their specific projects, organizing breakfasts with ministers that served as an occasion for open discussion of a range of issues of interest to investors. The establishing of the AFI as a key actor through which business concerns could be transmitted to the government also served as an important anchor helping to sustain the high-road of Czech Competition State even after the change of the government and the incumbency of the right-wing party.

The predominant view in Czech Republic at the time was thus certainly that the government needed to support *investment* rather than just any kind of wealth accumulation. Any proposals to lower taxes across the board were firmly rejected by the key policy makers as being simply ineffective. In the words of Jan Havelka: '*It is important to make sure that they (foreign investors) will keep the profit here and not transfer it to another country to their mother company through dividends. Especially since the current government* (ODS-led coalition government from 2011, op.a.) *has cancelled the tax on dividends. So low taxes can be targeted either dividends, that are then taken abroad, or on re-investments. And we used to say: fine, low taxes are good, but we need to have a tool to evaluate and reward companies who would like to use their profit for re-investment. This country is driven by two main tools: investment and exports. So low taxes alone, without incentives, do not make any sense. In that case, you can spend the profit on luxury cars or whatever. Why would I expand my factory and take the risk then? So this motivation is important, even if I have low taxes. And in such a situation, if I have a good motivation system through incentives, I can even easily increase taxes. To tell those guys: "well, if you are going to transfer that money abroad or spend it, you will be punished by higher taxes". If you are going to spend it for expanding business and increasing the richness of our economy, you will be granted incentives. Low taxes are just to help the rich people to become richer.'* (Havelka, interview)

A similar position was stated by the Prime Minister at the time, Miloš Zeman: '*Flat tax is one of the non-senses of Conservatives in my country. Flat-tax is in fact found only to the east of the Czech Republic – in Russia, in Ukraine, in the Baltic states, Slovakia and so on. Even in the States and in Western Europe, you have progressive taxation everywhere. Flat tax increases social disparity and increases the risk of deep social* *conflict. This is the political consequence of flat tax. And the economic consequences are very simple: you simply decrease the income for the state budget. Sweden has marginal direct taxation of 60%.'* (Zeman, interview).

Contrary to the widespread accounts in the literature on East European investment attraction as a straightforward 'race to the bottom' (Drahokoupil, 2009; Bohle, 2009: Appel, 2011), it should thus be emphasized that there was quite some disagreement and political conflict as to what this race should be about and whether investment incentives or overall tax cuts were the most appropriate instrument to use while battling for a share of foreign capital. Consequently, the lack of convergence on a single set of policies posited by the idea of a 'race to the bottom' did not come about purely because of the political or institutional constraints on adopting a particular set of 'second generation reforms' (O'Dwyer and Kovalcik, 2007). As a matter of fact, the very concept of 'second generation reforms' appears misplaced since it groups together a bundle of policies that simply do not appear together in practice. Rather, the divergence of the Czech and Slovak Competition States came about as a result of political competition and the structures of their political systems which allowed for the emergence of very different ideas on the best strategy for FDI-led development. The policies that are usually bundled together (investment incentives, flat tax, welfare cuts) actually appear to be parts of different political programs as, in reality, there would appear to be considerable political conflict between proponents of regimes with low- and flat-taxes, on the one hand, and advocates of generous investment subsidies, on the other. The fact that all of the relevant political actors agree on the importance of FDI does not mean that all economic and programmatic differences among them disappear – and the Czech Republic shows that these political differences do also matter for the set of policies a country actually develops. Furthermore, the above differences do not refer simply to conflicts over the choice of tax regime, but also to the way in which one perceives the welfare state and its relation to economic growth. Hence, in contrast to the simplified accounts of a Competition State as a mere 'race to the bottom', the case of the Czech Republic shows that the exact form of the Competition State implemented was very much a matter of political conflict and that its eventual development crucially depended on the balance of political power in the country. Even the emergence of the 'comprador service sector', which is depicted by Drahokoupil (2009) as the key element in bringing about Czech Competition State, was itself conditioned by the political developments since CzechInvest would never have received so much support and independence if ODS had have been in power instead of CSSD during the formative years of economic transnationalisation in the Czech Republic. Similarly, fiscal policy, often seen as entirely determined by the global race for capital (Appel, 2011), was also subject to politicization and the exact mixes of investment subsidies and lower corporate tax rates was again a matter of a political program based on a specific idea of competitiveness and state role in achieving it.

The debates that marked the birth of the Czech Competition State continued throughout the second mandate of the Social Democrats, this time with CSSD governing in a coalition government. In this period there were debates not only in the form of electoral competition with ODS, but were also *within* CSSD itself. Nevertheless, any attempts to steer Czech economic policy towards low taxes and lower welfare state payments still met with resistance and were not easily implemented during the CSSD-led administration. Hence, even if it was possible for the party or the government to try to slide towards low road, there were limitations as to how far they could go. The presence of leftist economists, the trade unions and left-wing academics all represented constraints that channelled Czech efforts at attracting FDI in a particular direction and prevented it from being focused on tax cuts. Similar to Slovakia, there were thus also voices in the Czech Republic claiming that higher taxes or high social contributions represented an obstacle to greater competitiveness. Still, in contrast with Slovakia, not only was there strong opposition to such views, but this opposition also coupled the same notion of competitiveness and integration in international markets with the viability of high social contributions and high wages instead of promoting an internally-oriented left strategy.

Consolidating Czech Competition State – 2002-2006

While the 2002-2006 period in Slovakia saw the consolidation of the low-road Competition State, with cuts in taxes and social expenditure, the introduction of flat-tax, and an overall push towards creating business-friendly environment, the Czech Republic at the same time witnessed divisions and some tendencies towards a low-road strategy on the part of its predominant Social Democratic party. The elections in 2002 returned the one-vote-majority government, where the goals of Social Democrats had to compromise with coalition partners that were of a much more liberal orientation (Christian Democrats and Freedom Union). Due to the ideological differences of the coalition partners and their tiny majority, for every important decision the government had to fight for that one vote necessary to pass the law in the parliament as it could not always count on its partners' full support (Mansfeldova, 2005).

When Vladimir Spidla took over the government in 2002, his primary task was to reduce the budget deficit (projected at 6.2%, so not meeting the Maastricht criteria) and he proposed a series of reforms to achieve this goal. Some of them included raising taxes as well as reducing public expenditure and speeding up the privatization of the telecommunication, petrochemicals and electricity companies. However, the proposed means of replenishing the state coffers was primarily through raising VAT rather than corporate tax or personal income tax. The VAT rules also had to be reformed due to the required harmonization with the EU, with the list of items subject to the lower rate being substantively narrowed, thereby leading to even less progressivity in the overall tax burden. Corporate tax, on the other hand, was reduced further. Indeed, according to Ernst and Young, 2004 marked an important change in the Czech corporate tax system (Fryzek and Zbroj, 2004) - in that year, corporate income taxes dropped from 31% to 28%, while it was scheduled that next year it would fall to 26% and then to 24% in 2006. Thus, as early as 2004 the effective tax rate was already lower than in Poland and similar to that of Slovakia. The drop in corporate taxes was, to a large extent, driven by developments in neighbouring countries. As Jan Mladek put it: '*The situation was very difficult. The first position was that we will never compete in this competition for the lowest corporate income tax. The other point was that we are not living in vacuum and with some delay we must follow what our neighbours do. And we did it.*' Particularly important in that respect were the reforms in neighbouring Slovakia. '*Slovakia is extremely important because you can argue that there are not so many Czech entrepreneurs that go and do their business in the Caribbean and organize a false company – this is not easy, you must go there, you must hire a lawyer, put money, it is difficult. But to go to Slovakia... any fool can do it! So Slovakia was always a strong argument. And not only Slovakia – Bulgaria, Macedonia, they are also not far away from here.*' (Mladek, interview). However, while the pressures of the fiscal race to the bottom were very visible for Czech policy makers, they were still not willing to engage in this race right until the bitter end, so they continued to maintain higher taxes Slovakia. The debate on tax rates in the Czech Republic clearly took on a European dimension that was also politicized along party lines. While ODS was strongly advocating tax competition in Europe as the best means to ensure convergence on the optimum tax rate (i.e. race to the bottom), CSSD was very clear not only about their willingness to tax more corporations in Czech Republic, but also on their opposition to any kind of tax competition in Europe. Consequently, the Czech corporate tax rate still remained higher than the Slovak one.

On the other hand, investment incentives and potential competition in government subsidies was obviously not seen as a problem for Social Democrats and the government maintained very generous investment incentives. These were, however, again criticized by ODS leader Mirek Topolanek, who announced that his party would consider abolishing incentives if they were to gain power (Association for Foreign Investors, 2004). Political opposition to investment incentives was also voiced by some small and medium entrepreneurs who formed the ODS' traditional base – but, as opposed to Slovakia, no association of Czech big businesses emerged to strongly lobby against the incentives. Despite the criticism coming from both the opposition and some domestic entrepreneurs, the government maintained its policy of strong investment support, as well as the scale of the resources committed to state aid for horizontal objectives. The latter actually increased from 487.2 to 732.8 million Euro between 2002 and 2006 (European Commission, State Aid Scoreboard).

In 2004, after the government crisis and following the Social Democrats' poor showing in the European Parliament elections, Vladimir Spidla resigned as Prime Minister. His successor was Stanislav Gross, a young leader (who subsequently had to resign for corruption scandals), who named a former CzechInvest CEO, Martin Jahn, as the Deputy Prime Minister for Economy with the tasks of preparing the Strategy for Economic Growth 2005-2013 and the National Lisbon Programme 2005-2008, both approved by the government in 2005. As a non-party member, however, Jahn espoused some ideas in the strategy that did not meet with the approval of Social Democrats and some of the economic advisors of the party, especially those such as Jaroslav Ungerman and Milos Pick who were known for their more leftist orientation, criticised the strategy heavily (Ungerman, interview). Their argument was that the strategy prepared by Jahn's team did not meet either the economic or political goals of the Social Democrats. In terms of economic goals, they argued that focusing on lowering labour costs and cutting taxes represents the strategy of low-road competitiveness, whereas the Czech Republic should instead aim at high-road competitiveness based on knowledge and the skills of the labour force. Furthermore, the argument was that cutting taxes would be to engage in unfair competition towards other states in the European Union and that the Czech Republic should not start that kind of 'race to the bottom'. Finally, with regards to the political problems with the strategy, Ungerman and Pick argued that, due to its focus on cost competitiveness and tax and social contribution cuts, the strategy did not depart much from the election programme put forward by ODS and, therefore, it was politically unacceptable to Social Democrats (CSSD, 2005). The debates on high-road and low-road competitiveness were not finally resolved until the end of the mandate – the Strategy was adopted, but it was supposed to be changed after the elections. However, the elections saw CSSD ousted from power and the new government simply ignored the strategy. Nevertheless, even if CSSD had won the 2006 elections, the strategy would still have been shelved or radically altered as even the Prime Minister became less enthusiastic about it after realizing the extent of the opposition to it within his own party (Mladek, interview).

The debate over the 'Strategy for Economic Growth' highlighted how the idea of lowering corporate taxes or social contributions because they are obstacles to increased competitiveness could be criticized precisely because it is based on cost-competitiveness, whereas the Social

Democratic program is supposed to be based on quality competitiveness which brings with it higher wages and does not assume a decrease in labour costs (CSSD, 2005). Hence, the debate demonstrates two things: first, that competitiveness indeed *was* an relevant issue and an important one for Czech social democrats who *did* identify it with the ability to actively attract bigger amounts of often more technologically advanced investment; and, secondly, that they also had quite a clear idea on the *type* of competitiveness they wanted to pursue and its implications for specific policies, including the notion that welfare state or high labour costs (as long as their rise is in line with the increase in productivity levels) are by no means an obstacle for such competitiveness. In other words, a high-road Competition State was indeed a distinct state project advanced by concrete actors in a concrete political party that happened to be in government for 8 years. Furthermore, although there were some disagreements within the party on the details and specific policies to be pursued, there was still a coherent position formulated in defence of such a state project.

Welfare state reforms – the first CSSD government (1998-2002)

In the view of Czech Social Democrats, reorienting towards attracting FDI was by no means associated with welfare cuts. To the contrary, before the 1998 elections they campaigned on the basis of a 'socially and ecologically oriented market economy' and fiercely criticized the Klaus government for viewing social policy as a necessary evil and social expenditures as a non-productive drain on investment (Rueschmeyer and Wolchik, 1999). Still, the main underlying idea of their social policy was that of an equality of opportunity rather than an equality of outcome, with the government promising equal access to education, employment and 'civic and personal self-determination'. However, the implementation of such a broad agenda was stalled by budgetary constraints and the rising deficit, as well as legislative delays caused by the minority status of the government (Potucek, 2004). In other words, the priority of the government clearly lay in expanding investment in infrastructure or building industrial zones rather than in raising social expenditure. Overall thus, the Zeman administration was marked by the *absence* of radical reforms either in pensions, health care or labour law – in contrast with the Slovak neoliberal government's approach to building a Competition State, the Czech Social Democrats certainly did not consider radical social reforms to be an integral part of their strategy for increasing competitiveness. By comparison with the government of Vaclav Klaus, they clearly developed a distinct rhetoric about social policy, promising to build a strong welfare state as part of their social democratic agenda, but they did not actually make many policy reversals. The main reason for this is that during the neoliberal government, as argued earlier, the welfare state was far from being purely neoliberal. Nevertheless, the reforms that the Social Democrats did implement certainly went in the direction of increasing social expenditure by increasing the family benefits and abolishing targeting in the provision of children allowances. At the same time, they substantively *increased* spending on education, which rose from 3.95 in 1998 to 4.32% of GDP in 2002 – in the context of simultaneous GDP growth. Most importantly, they renewed the Tripartite Council and gave a much more prominent role to trade unions in policy making, even appointing some union leaders to important public positions. The result was not an astonishingly generous welfare state, but it was still more generous than during Klaus' time – social expenditure as a share of GDP rose from 18.5% in 1998 to 20.2% of GDP in 2002. However, what is more important from the perspective of the transformation from welfare state to Competition State is that they did not seek to *retrench* it and nor did they attack it as a burden on increasing competitiveness; rather, they sought to preserve and expand the existing measures of social protection and they also sought to maintain the progressivity of taxation.

However, the point where they were ideologically very far from the traditional Social Democratic welfare state was in the field of policy towards the unemployed – these benefits were kept low and, while active labour market policy schemes received more funds than before, the job search requirements became more stringent than during the ODS government. The end result was thus a fairly generous and expensive social policy, but the one aimed primarily at activation and participation in the labour force – in other words, generous workfare rather than generous welfare state.

As regards pensions, the party's platform actually planned to eliminate the planned increase in the retirement age and also proposed increasing the average pension to at least 50 % of the average wage. It also proposed the creation of a social insurance system separate from the state budget. Nevertheless, none of this was actually achieved and the only change that the government introduced to the pension system was an amendment to the law on supplementary private insurance in 1999 aimed at improving the security, regulation and supervision of pension savings - the latter was basically part of the broader program of regulation of financial sector in Czech Republic. The draft bill founding a Social Insurance Agency that would have separated pensions from the state budget failed to pass thought the Parliament in 2001. By remaining a part of the state budget, pension financing and the deficit on the pension account remained less transparent than is the case in countries with social insurance agencies – such as Slovakia, for instance (Lesay, 2009). However, as the pension system was running a deficit in 1997, the Minister of Labour and Social Affairs, Vladimir Špidla, proposed to increase the pension insurance payments by 2.4% - 1.8% on the employers' side and 0.6% on the employees. In 2001 the government also reduced the level of early retirement benefits. As for the family policy, the party proposed a return to a universal rather than a needs-based system of children allowances, while in health-care policy CSSD proclaimed that the state-based health insurance would remain the basis of health care. It also proposed an increase in sick pay benefits and a 17% increase in wages in the public sector after an agreement with public sector unions in September 1998.

Clearly, thus, at this stage there was no concern with the high non-wage labour costs being a drag on country's competitiveness. To the contrary, the strategy of lowering labour costs was perceived as distinctly right-wing. In the words of Miloš Zeman: '*Let me quote Tony Blair here as he said: we do not need low cost labour, we don't need badly paid labour; we need well paid labour and we need qualified labour. That is why we supported investment into education, requalification and so on. And the growth of real wages has been about 6% annually. The conservative strategy which says that we must put labour costs on the level of China is nonsense, because you take away consumption.'* (Zeman, interview)

Still, the Czech Social Democrats social policy clearly maintained a workfarist outlook at least in the sense that unemployment benefits were seen as counterproductive and better replaced by public works – in September 1998 Zeman proposed to use a public works scheme as a substitute for unemployment benefits, provoking some protest from labour groups. The proposed 'National Plan for the Battle against Unemployment' saw an additional two billion crowns allocated for active employment policies, including some requalification programs and schemes to assure employment for young people who have finished their education (Rueschmeyer and Wolchik, 1999). The National Employment Act of 1999 also raised the job searching requirements for the unemployed. At the same time, the ceiling of unemployment benefits was increased from 1.5 times the minimum subsistence level to 2.5 times (2.8 for those undertaking vocational training), but the replacement rates were left intact from the period of the Tosovsky government. The living minimum was also not re-evaluated so that the value of social assistance benefits continued to decline – while in 1991 the minimum income scheme provided for 55% of the net average wage for a single person, by 1998 this had dropped to 37%, while in 2000 it fell further to 35%. The government clearly put more emphasis on active labour market policy – in 1998 ALMP (not including the administration of labour offices) took up 18% of total labour market policy expenditure, while in 1999 their share increased to 25%, reaching 44% in 2002.

The ideology of 'work first' was thus firmly entrenched in the CSSD approach, and it was also associated with its overall focus on increasing investments. In the words of Milos Zeman: '*If you try to orient yourself towards the unemployed for instance, this is the target group for Communist Party which is still strong in Czech Republic. I have nothing against the unemployed people, but what is the main difference?*

Some part of Czech Social Democracy, let us say official Social Democracy, tries to pay higher subsidies for unemployed people. Good solution? I do not think so. You must create new opportunities for labour, new jobs. And in order to create those jobs, you must invest, not consume, but invest. It is the Protestant ethics of Max Weber. That's why in our program, we say, we prefer investment, not consumption. But of course investment has no voting rights – we cannot expect support from new highways, new factories, new houses for pensioners, reconstruction of castles and so on, because investment has no voting rights. Nevertheless, I think it is the best strategy against unemployment. Not subsidies. Subsidies in fact increase the unemployment rate, instead of decreasing it. (Zeman, interview)

Another part of the efforts to make working attractive was the increase in minimum wage, which now came close to the average EU level of replacement rates of minimum wage. Still, while wages were increasing, the living minimum was not – thereby leading to further erosion of the social assistance benefits replacement rate. The administration of social assistance benefits was, however, still kept separate from the administration of unemployment benefits and active labour market policies – while social assistance was administered by the social departments of municipalities, labour market policies were administered by the Public Employment Service as the administrative body of the Ministry of Labour and Social Affairs. The municipalities in charge of social assistance benefits thus did not have any direct influence on the activation of the recipients, although the recipients had to show proof that they were registered as unemployed with the Public Employment Service, and in order to retain this status they would have to comply with job search provisions demanded by the employment service.

Overall thus, while early years of Czech transformation were indeed accompanied by emergency welfare state building and social policies as compensation for market liberalization, after the shift from national to transnational capitalism, the welfare state clearly took on a more workfarist outlook. Hence, recommodification – rather than decommodification or compensation for the adoption of an externally-oriented strategy – was the guiding principle behind the social reforms. Nevertheless, as it was based on retraining schemes and investment in education, this recommodificaiton was still more generous and activist than was the case with the low-road Slovak Competition State. Thus, while the Czech post-1990s welfare state can indeed be described as a workfare state, the specific type of workfare or productivist social policies was still a matter of political choice of the governing Third Way Social Democrats, rather than simply an apolitical response to the challenges of globalization.

Welfare state reforms – CSSD coalition government (2002-2006)

After the elections in 2002, social policy acquired even more of a Blairist Third Way profile. The coalition government of Social Democrats, Christian Democrats (KDU-ČSL) and the liberal Union of Freedom (US), with its tiny majority in the parliament, was certainly not conducive to any further expansion of the welfare state as any social policy proposals had to be based on the outcome of negotiations between parties with quite different ideological outlook.

Faced by the high implicit pension debt and a rising deficit in the pension account, as well as an overall budget deficit, the government started to discuss pension reform. However, in contrast with Slovak reforms, the Czech proposals were far from adopting the World Bank model of fundamental reform with a mandatory private pillar. The Social Democrats' rejection of the idea of fundamental reform was based on several reasons: the fears of the high transition costs associated with such a fundamental reform; the general skepticism towards private investment funds stemming from the bitter experience, shared by both policy makers and the general public, of the voucher privatization; and the reluctance to order people to save if the government could not guarantee these savings. Most importantly, not even the right-wing parties subscribed to the World Bank model. Fort their part, CSSD proposed to introduce a Swedish-style model and thus switch from a pay-as-you-go system with defined benefits to a system which was still public and funded on a pay-as-you-go and NDC (notional defined contributions) basis, but where people's contributions were to be stored in virtual accounts and their benefits calculated on the basis of individual contributions. Although not shifting from public to private management of funds, the NDC system still implies an individualization of risk, rather than risk-pooling which was the hallmark of the defined benefits PAYGO systems typical of traditional European welfare states – thus, even the Social Democrats' ideas at the time were much closer to the risk individualization paradigm of New Social Democracy than to the risk pooling concept of the Golden Age. Nevertheless, this insurance scheme was still supposed to remain mainly in the public hands, especially since, in the context of rapidly rising budget deficits which already failed to meet the Maastricht criteria, shifting part of the contributions to the private pillar risked increasing the budget deficit even more.

The discussion on pension reform resulted in the creation of a multi-party expert commission, the so called Bezdek commission, which calculated the implications and the expected consequences of each major party's proposal of pension reform. The proposals put forward by the different political parties showed that there was no government in the Czech Republic that was prepared to make pension privatization its priority, as pointed out by Lesay (2009), but also there was also no political *party* at the time that was clearly advocating a mandatory private pillar. The ODS proposal was actually in favour of flat state pension (flat benefit, not flat rate), supplemented by the voluntary private pension funds which were already operating. As Petr Mach, the ODS representative on the Bezdek Commision, put it: '*as libertarians, we rejected any obligations imposed on citizens by the state'* (Mach, interview). Thus, while in Slovakia the discourse on a 'modern' social system in a 'competitive' market economy included pension privatization with a mandatory private pillar as one of its important dimensions, in the equally competitiveness-concerned Czech Republic not even the right-wing party considered it a desirable course of action.

Still, all this discussion did not lead to a fundamental pension reform being implemented in Czech Republic at the time – not even the shift from inter-generational solidarity based on PAYG to NDC system. Rather, a parametric change was introduced in 2003 with retirement age increasing yet again – this time reaching the age of 63 for men and women without children (Potucek, 2008). As the government did not increase the value of pension benefits in line with the growth of wages, by 2005 the average pension amounted to only 52.8% of net average wage, substantially lower than the 1990 level of 66% (Potucek, 2008).

The government also expanded family policy in a populist move introduced by Gross in the election year (from 3 to 4 years of parental leave) as well as doubling the benefit paid after the first six months of the parental leave. The government also introduced a universal one-off child grant and increased the generosity of the grant. However, despite its electoral promises of introducing universal children allowance in place of the means-tested one, due to opposition from amongst the coalition partners this was never achieved (Potucek, 2008).

Labour market policy, on the other hand, remained firmly concerned with activation, making work pay and combating 'the misuse of social benefits'. Indeed, despite numerous other differences in the discourse and attitudes towards the welfare state between the left and right political parties in Czech Republic, 'the misuse of social benefits' and the need to make work pay are a consistent theme across the political spectrum, accepted by both CSSD and ODS (various expert interviews). The discussion about the need to reform and adapt social assistance and unemployment benefits schemes has, since the late 1990s, focused on the question of providing economic incentives to work by distinguishing the material situation of those who are actively seeking work or working for low wages from those who have become 'welfare dependent' (Sirovatka, 2008). The first steps that the 2002-2006 Social Democratic government implemented actually went in the direction of introducing more generosity while strengthening the job-search requirements – i.e. they tended towards a more generous workfare state. Thus, as part of the harmonization with the EU, the replacement rate for unemployment benefits received in the second three months of unemployment was increased from 40% to 45% in 2004 (Saxonberg and Sirovatka, 2009). Furthermore, the duration of benefits for persons above 50 years was increased from 6 to 9 months, while for those above 55 years it was 12 months. However, as the benefits were still capped at the 2.5 times the living minimum level, the replacement rate for higher wages employees were extremely low. The government also further increased the minimum wage – from 31.2% of the average wage in 2000 to 39.4% in 2006. In addition, the concept of the subsistence minimum was introduced, which was lower than the living minimum and was defined as the amount of income enabling survival. This income was something that even the 'passive' and the 'undeserving' unemployed were entitled to receive.

At the same time, the requirement for unemployed persons to search for jobs has been made stricter. The definition of the 'suitable job' that an unemployed person is supposed to accept has been broadened to include temporary positions longer than 3 months and taking up not less than 80% of the full working time. For the long-term unemployed, the definition is even broader as the job may have an even shorter duration and must only take up at least 50% of their working time. Qualification, abilities, accommodation or the accessibility of transport are also no longer taken into account, leaving only health status as a legitimate reason for not taking up a job. Furthermore, unemployment benefits can be suspended for 6 months whenever an unemployed person refuses to participate in a temporary job (including public works) scheme or to undergo health examinations required by the Employment Office, as well as in case of non-compliance with the commitments set down in their Individual Action Plan. Studying, which previously counted as a substitute to the working period, were no longer considered as such so that school graduates could access unemployment benefits only if they had the required work record of at least 12 months within the last three years. Furthermore, thanks to the money from the European Social Fund, the funding for active labour market policies was substantially increased, raising also the participation in ALMP from 19% of total stock of the unemployed in 2005 to 39% in 2007 (Sirovatka, 2008). Overall, thus, the reforms in the labour market policy can certainly be described as even further advancement towards workfarist logic – but coupled with the slight increase in benefits, increased spending on an active labour market policy as well as making-work-pay through increasing the minimum wage rather than through decreasing benefits, it was certainly movement towards a generous rather than a mean workfare.

The reversal, however, came towards the end of the mandate when, based on the results of the study on living minimum it ordered from the Research Institute for Labour and Social Affairs, the government adopted the Act on the Existence Minimum and Subsistence Minimum and the

Act on Assistance in Material Need which both came into effect in January 2007. These further reduce the social assistance benefits level, while worsening the conditions for the recipients. As of 2009, if the state authorities decide that an unemployed person is not showing enough willingness to find a job, his or her social assistance can be reduced to 2/3 of the subsistence minimum for a single person. In addition, the law stipulates that, when testing the means for subsistence, an adult children living with their parents creates a household – a measure that, to a large extent, excludes unemployed youths from access to benefits. The result of these measures has been that the number of recipients of social assistance benefits dropped from 169,000 in 2006 to 72,000 in 2007. Other measures seeking to increase the incentive to work include the change in the calculation of the subsistence minimum where only 70% of income from work but 80% of income from sickness and unemployment benefits is taken into account when assessing the need and the individual's income vis-à-vis the minimum subsistence level. Extra bonuses were also adopted in the calculation of the minimum subsistence level in case a person is actively looking for job and is able to vouch for expenses related to their job-search. Changes also saw more emphasis put on working individually with the recipients of social assistance benefits, including the introduction of an obligation to develop activation plans for those who receive social benefits for more than six months – and this in addition to the Individual Action Plans implemented by employment offices. Hence, the Social Democratic government certainly went great distances in the aim of motivating the labour force to work or search for whatever kind of jobs were available.

At the same time, there were attempts to adopt a more flexible labour law. The new Labour Code was proposed in 2005 and approved in 2006. The Law, for the first time, changed the principle that 'what is not permitted is forbidden' to 'what is not forbidden is permitted' and in that sense it represented a substantive liberalization of the previous Code. Of course, employers still called for more flexibility, while trade unions argued that it was already too flexible. One of the novelties that the Code brought in was the introduction of working-time accounts. Another was the elimination of the 'offer obligation' which obliged an employer to offer an alternative position to an employee in case of contract termination.

Overall, welfare state reforms during the second CSSD government thus represented stability with respect to pensions and health care, expansion in family benefits and an even more explicit orientation towards workfare and flexibility in labour market policy. At the same time, the commitment to investment in human capital was also preserved with education expenditure increasing from 4.3% of GDP in 2002 to 4.6% in 2006. Hence, rather than a retrenchment, the policy was actually still one of preserving the core of the welfare state, but giving it a more recommodifying character. The creeping neoliberalization observed by Saxonberg and Sirovatka (2009) thus came about primarily through the failure to adjust the subsistence minimum in line with the increases in the living standard and the concomitant failure to adjust social assistance and unemployment benefits. Nevertheless, this drift primarily concerned policies directly related to labour force supply and motivations, rather than affecting the entire welfare state architecture. The relative generosity of the Czech welfare state from the late 1990s onwards did not, however, represent further efforts at decommodification or compensating citizens for the increased economic transnationalisation. It was also not an attempted act of balancing between the necessity of adjusting to the needs of the global economy, on the one hand, and preserving social cohesion, on the other. Rather, the absence in the Czech Republic of the kind of radical welfare reforms witnessed in Slovakia was the result of a *different* economic strategy and a different vision of what constitutes competitiveness, where the welfare state or the higher tax burden were not seen as a problem in the first place. It was thus not the case that higher social expenditure was maintained due to a logic that would be fundamentally opposed to the overall governmental economic growth strategy; nor was it that Czech policy makers could somehow simply ignore the pressures and the sets of constraints and opportunities offered by the context of increased economic transnationalisation. Rather, the way in which these constraints and opportunities were conceived, as well as the economic strategy for FDI-led development in the Czech Republic, was itself designed and articulated in such a way that there was no contradiction between higher social expenditure or higher labour costs and increased competitiveness in the first place. The reforms that the Social Democrats implemented show that the implications of social policy for economic growth were indeed taken seriously – however, the idea of economic growth and its relations with different social policies implied a reorientation and transformation of the welfare state rather than its dismantling.

Conclusion

The late 1990s in the Czech Republic brought about a substantive reorientation from national capitalism building to externally oriented development based on FDI. Although such a change would have probably taken place even without the change of government, since national capitalism was a political project, it is difficult to imagine that its failure could ever have resulted in a political crisis without a change in government. And although both ODS and CSSD had, by that time, embraced the idea of attracting FDI, they still had fundamentally different attitudes on how this should be achieved. It is thus the incumbency of Social Democrats that explains the particular high-road type of Czech transformation, with the emphasis on investment incentives and an 'active industrial policy' rather than tax cuts, as well as with retaining the institutions of the welfare state. At the same time, the reorientation towards attracting FDI did not bring about any particular changes in the field of social policy. Rather than seeing the welfare state as a burden on competitiveness, Czech Social Democrats actually perceived the process of increasing competitiveness as a means to *increase* wages and saw the welfare state as a legitimate part of such a strategy since lowering labour costs was not part of their competitiveness agenda. The welfare state did not, however, see large scale expansion, but one sector that certainly did expand was education which saw a large increase in its budget for 1999 and 2000 – virtually higher than any other state sector (Cerych, 2000). The idea of preserving the welfare state and maintaining redistribution was still coupled with concerns on the presence of work-incentives for the population and with the attitude that an active policy was the most appropriate labour market policy, while unemployment benefits only increase dependency and the unemployment rate. Overall, rather than cutting social spending, the government of Czech Social Democrats maintained the levels of social generosity while investing substantially more resources into education and active labour market policies. The generous workfare state and generous investment promotions thus meant that the establishment of the Czech high-road Competition State began as early as the first years of the transnational capitalism building and, thanks to the prolonged incumbency of the Social Democrats, it has largely preserved its character until the advent of the latest financial crisis.

During the second CSSD mandate, the government continued to grant generous investment incentives and financed the expansion of the marketing and promotion activities of CzechInvest. Through the activities of AFI, as well as through the creation of governmental institutions, the voice of foreign investors was widely heard in Czech policy making – but they were primarily concerned investment incentives and the support for large investment projects, rather than pushing for low taxes overall. The government also started to develop a more liberal approach towards increasing competitiveness; however this triggered strong reactions from trade unions as well as from experts within the Social Democratic party, thus preventing the government from sliding towards the low road. Some concessions were still made, primarily in response to developments in neighbouring countries and corporate taxes were further reduced, but they were still higher than in Slovakia. At the same time, the government increased VAT so, rather than reducing tax revenues altogether, they shifted the burden of taxation from direct to indirect taxes.

Contrary to some accounts that see the Czech Competition State as an apolitical response to the structural pressures of globalization, it is clear from the above that the particular *form* that this state took was actually very much the result of domestic political agency. Transnational capital did indeed have both structural and agential power (Drahokoupil, 2009), but the exact policies designed to attract transnational corporations as well as the institutions enabling the TNCs to voice their own particular demands – such as the Association of Foreign Investors established by CzechInvest – were themselves designed in light of the ideas and power constellations of domestic political actors. In other words, if ODS had been in power instead of CSSD in the crucial years of the formation of the Czech Competition State, it is quite unlikely that CzechInvest would have gotten such political backing nor would it have gone on to become the cornerstone of the Czech strategy for increasing competitiveness. While the fact that the Agency was simultaneously autonomous and embedded in economic networks through its regularized exchange with foreign investors might indeed suggest that the Czech Competition State resembled a transnationalized version of the 'embedded autonomy' of Peter Evans' 'developmental state', this autonomy was itself largely the result of a particular political program that saw an activist state rather than minimalist state as the main prerequisite for attracting FDI and increasing competitiveness.

On the other hand, contrary to certain other accounts that see the preserved generosity of the Czech welfare state as simply the continuation of its Bismarckian continental historical legacies (Inglot, 2009; Potucek, 2008), it should be emphasized that this welfare state was still restructured and made compatible with the requirements of transnational capitalism building, as witnessed by its turning more towards recommodification rather than decommodification or status-preservation. Yet, in stark contrast to Slovakia, the restructuring of the Czech welfare state did not represent retrenchment, but rather re-orientation without shrinking. The latter was again the result of the Social Democrats' political program that sought to increase competitiveness primarily on the basis of highly skilled and high wage labour, rather than purely on the basis of a low-cost business environment.

Competition State under the Czech right

Introduction

The 2006 elections in the Czech Republic saw a coalition of right-wing parties come into power – the results of the elections were extremely balanced (100 seats for the right, 100 for the left parties in the House of Deputies) and it was only with the abstaining of two CSSD MPs that ODS managed to form a right-wing coalition under the Prime Minister Mirek Topolanek. The government was soon faced with an economic slowdown because of the global crisis that began with a financial crash in the USA leading to decreased demand in Western Europe and translating into a fall in Czech exports. GDP growth slowed down in Czech Republic for the first time in 2008, turning negative in 2009. As the country was not exposed to high financialization, but was rather dependent on FDI in manufacturing and on the continuous exports to Western European markets (in particular Germany), the crisis did not manifest itself as a credit crunch or a banking failure since the Czech subsidiaries of foreign banks remained much more prudent in their lending practices and they also avoided issusing high proportions of foreign currency denominated credits (as opposed to their Hungarian counterparts, for example). Rather, the crisis emerged primarily due to the slowdown of economic activity in Western Europe and the fall in demand for Czech exports. Indeed, in 2009, the fall in exports was equivalent to 19% of GDP – however, after the stimulus packages introduced by the West European governments, in particular the car scrappage scheme introduced in Germany that favoured precisely the smaller and cheaper cars that the Czech Republic produced, economic growth resumed again.

At the same time, the government inherited a budget that was not in balance, and both the budget deficit and the economic crisis were used as a pretext for the right-wing parties to try to introduce reforms similar to those witnessed in other East European countries such as Slovakia or the Baltic states: pension privatization, health care privatization, flat-tax, social benefits cuts. To be clear, these were all on the agenda of ODS already before the elections and before the onset of the economic crisis; hence, during their mandate in government they simply tried to put all these ideas in practice. However, partly due to the pressure of Czech public opinion, which was never particularly in favour of radical welfare state retrenchment; partly because of the very weak majority in the Parliament; and partly because of the compromises ODS had to make with coalition partners, none of the right-wing governments managed to implement reforms that would put Czech Republic on a par with its Eastern neighbour Slovakia. Furthermore, the opposition CSSD maintained the stance that some of the reforms would be reversed if they succeeded in returning to government (highly likely, given the balance of forces in the Parliament), which also reduced the enthusiasm of private actors for substantive welfare privatization. Thus, the high-road Competition State remained in place despite the change of government from a CSSD- to an ODS-led coalition.

Politically, 2006 saw the formation of an ODS government with nine members from ODS and 6 independents. This government did not get the support of the Chamber of Deputies, but it continued working as caretaker government until January 2007 when the second Topolanek cabinet was appointed – this time a coalition government consisting of ODS, Greens and Christian Democratic Union–Czechoslovak's People Party. The Christian Democrats were at the time run by Miroslav Kalousek (later the leader of TOP 09) who was appointed as Finance Minister. The weak support for the government in the electorate was already apparent in November 2008 when the Social Democrats won both the regional elections and the elections for Senate. However, in December 2008 they still failed to have a vote of no-confidence passed in order to topple Topolanek's government and spark early elections. The government thus lasted until 24 March 2009 when CSSD finally succeeded in obtaining a no-confidence vote in the Chamber of Deputies by getting four members of the ruling coalition (including the two ODS MPs) to vote with the opposition. Topolanek resigned and the caretaker government, under Jan Fischer, led the country until the elections in 2010. Victory in the 2010 elections actually went to CSSD in that they claimed the greatest share of the votes - however, since even together with the Communists they could still not create government, and as the three right-wing parties together had 118 out of 200 seats, the Czech Republic ended up with another right-wing coalition government. The subsequent sections will however focus mostly on the policy developments during the two Topolanek governments (2006-2009) since the crisis and post-crisis developments are not the focus of the thesis. The discussion of the reforms undertaken by the right-wing government thus serves primarily to show how and why the policies and the institutions of the high-road Competition State developed by Social Democrats turned out to be difficult to overhaul even when more neoliberal parties were in power.

Economic reforms

The economic reforms during the Topolanek era represented a continuation of the business-friendly reforms already introduced by CSSD, but this time giving it a more definite twist towards a low-road strategy. At the same time, however, social reforms were also introduced with the aim of cutting public social expenditure and shifting the provision to private providers. Faced with the economic slowdown as a result of the global financial crisis, Topolanek's government also introduced an institutional innovation – the National Economic Council (NERV), an advisory body comprised of 10 economists whose main role was to find the most appropriate form of economic reforms and measures. The council was founded in January 2009, when the Czech Republic started to feel the first signs of economic recession – it was then briefly suspended in September 2009, during Fischer's caretaker government, but it reconvened in 2010 when Petr Necas took over the reins of power.

Even before the advent of the crisis the government had started to pursue certain reforms that ODS had promised in its election campaign. In particular, these referred to further cutting corporate income tax, introducing flat-rate personal income tax and curbing investment incentives. During their time in opposition, ODS was indeed very critical towards the generous investment incentives that the government was handing out – partly because they were traditionally the party of domestic businessmen and small entrepreneurs that felt discriminated by the CzechInvest activities, and partly because of their ideological resistance to any kind of interventionism which meant that they saw investment incentives as yet another dimension of the state's undue interference with the markets. Their proposals were thus that, rather than giving incentives to specific investors, the government should adopt low taxes for *everyone* and thereby reduce the distortion it creates in the market. Their campaign pledges included not only reducing corporate income tax, but also adopting a 15% flat tax for personal income, VAT and corporate income.

Given the announcements before the elections and the position of the appointed Minister of Industry and Trade, Martin Riman, it was expected that ODS would actually completely abolish all investment incentives. Riman, an economic liberal who had been seen to support the ideas of certain neoliberal think-tanks (such as the Centre for Economics and Politics, established by Vaclav Klaus) that were very critical of investment incentives, strongly criticised the incentives while he was in opposition, arguing that a fairer way to create a business friendly environment would be to cut taxes for *all* entrepreneurs (Mach, interview). Nevertheless, despite the neoliberal ideas of the officials in the Ministry of Industry and Trade, the levels of horizontal state aid continued to increase from EUR 765 million in 2006 to EUR 1066m in 2008, dropping only in 2009 and 2010, but rising again to EUR 1,121m in 2011.

Rather than abolishing investment incentives, the government actually restructured them and changed the rules determining eligibility for investment support. The duration of the incentives was cut from 10 to 5 years, while at the same time the threshold for the level of investment required for receiving incentives was lowered thus actually broadening the overall basis of the granting of state aid. A less radical policy was eventually adopted after Riman found it 'politically impossible' to abolish the incentives – partly because regional level ODS officials were also in favour of retaining the investment incentives as the arrival of the new investments posed good opportunities for political promotion (Mach, interview; Havelka, interview). Cutting the incentives from 10 to 5 years indeed made it much less attractive for big and capital intensive investment since these typically do not record profit in the first five years – so a five year tax-holiday would not bring them much relief. Consequently, those who primarily benefited from the reform were smaller enterprises. In the neoliberal worldview, reducing the threshold – and thus actually increasing the total level of state aid – was justified since because it reduced the government's role in choosing whom to support and so cut down on the 'distortions' to the market (Mach, interview). Hence, as the right-wing government found it politically difficult to abolish the institutions of the activist Competition State established by its social democratic predecessor, it instead opted to restructure them in a way that was more compatible with their political ideology, as well as their base of political support. Paradoxically, despite the ideological opposition to an 'activist industrial policy', the neoliberal government ended up giving more, rather than less, state aid.

Riman, however, adopted a much more hostile attitude towards CzechInvest than his Social Democratic predecessors. '*Even before coming to Ministry, Riman declared he wanted to simply dissolve the CzechInvest team, that it was unnecessary, disturbing, discriminating against the Czech industrialists and enterprises. So they still had this nationalism in their heads – they declared themselves liberal, but their basic attitude was still some kind of patriotism, nationalism, which did not match their official ideology.'* (Havelka, interview). Rather than completely dissolving CzechInvest, the ODS government simply put it under much more direct political control. The main reason for this, according to Jan Havelka, was the fact that, since 2005, CzechInvest was responsible for the distribution of the EU Structural Funds. This made it very attractive for politicians to try to control the institution and use it for channelling the funds to projects or enterprises they found political useful. '*In 2006 CzechInvest was responsible also for the Structural Funds. Jahn succeeded in merging it with a small agency called CzechIndustry, which had been established quickly before this merger, as well as with the agency responsible for* *supporting SMEs; together they became the Implementing Body for the Structural Funds. So, suddenly, an agency which employed around 100 to 150 grew into a small ministry. Beforehand we were the Implementing Agency for PHARE, but that was a relatively small amount of money, mainly for technical support. But after entering the European Union, the structural funds coming to the Czech Republic grew a lot and unfortunately it started to be very attractive for political games. And CzechInvest suddenly became attractive as a political target. So in 2006 Riman kicked out practically all management – and with these few top people around 60 other people went in protest. From that time CzechInvest started to be a political ´trafika´.'* (Havelka, interview). Furthermore, the fact that CzechInvest was appointed as the Implementing Body for the Structural Funds also made it practically impossible to abolish the agency, since the accreditation process for becoming an implementing body is itself quite long and cumbersome so that it would be very difficult to simply pass on that task to another state agency. Rather than dismissing the agency, the ODS strategy was simply to take control over it – from 2006 onwards the CEO was typically a political appointee while the agency came to be used as an organization in which political parties could temporarily 'store' their officials for which they do not have another attractive position at that moment – a function which, in the Czech and Slovak context, is often referred to as 'political trafika'. (The concept of political 'trafika' actually comes from the post-World War I period and the policy of Czechoslovak president Masaryk of giving war veterans licenses to operate as small street vendors selling newspapers and tobacco, so called 'trafika'. Political trafika thus designates a state agency which is used to grant positions to politicians or officials at the time when their careers are temporarily 'on ice'.) The need to guarantee the loyalty of the CEO of CzechInvest thus appeared parallel with the increased responsibility of the agency in supporting domestic investors as well. *'There is a lot of money coming through it. CzechInvest is now evaluating all the candidates for the support from the structural funds and making the recommendations. The decision is taken by the Ministry and the Ministry is under the control of politicians of course, and for them it is important that the evaluation is favourable towards certain candidates.'* (Havelka, interview). Hence, the earlier independent position of CzechInvest also turned out to be the result of the political commitment to investment support by CSSD rather than a permanent feature of the Czech more autonomous or more capable state. Nevertheless, despite politicization, the levels of investment support remained high throughout the right-wing government.

Flat-tax – Czech style

As already stated, the core of the ODS platform featured low and neutral taxation rather than an activist industrial policy. Yet, the flat-tax reform they implemented represents another example of radical electoral promises being watered down in the course of the actual promulgation of the bill. During the election campaign, ODS proposed the introduction of single flat-tax rate of 15% for VAT, personal income tax and corporate income tax. The flat-tax proposal was developed by Vlastimil Tlusty, the then shadow minister of finance in ODS, whose main advisor and consultant in developing the reform was Sulik, the author of the Slovak flat-tax reform. The Christian Democrats, on the other hand, proposed a flat-tax only on personal and corporate income tax, while the third party of the governing coalition – the Greens – were actually against the flat-tax and advocated a so-called ecological tax reform, increasing the indirect taxes on electricity, coal and gas. The fiscal reform that was actually adopted in 2008 represented a compromise between these three positions. Instead of a flat-rate 15% VAT, the government retained the lower VAT rate for some goods, though increasing it from 5% to 9% as was in the program of Christian Democrats. As for the initially proposed 15% personal income tax rate, it was changed to 18%. Moreover, the government actually chose to take super-gross-income as the tax base, so including all social security contributions. The result is thus that the equivalent tax rate at net income would be around 23% - so still higher than the Slovakian's 19%. Indeed, corporate income tax was the only one that continued to fall - from 24% in 2006 to 21% in 2008, 20% in 2009 and 19% in 2010. Although this represented a continuation of the trend already started by CSSD, the right-wing government certainly went further. Nevertheless, the overall fiscal reform was still much more moderate than the Slovak one.

Not surprisingly, the trade unions strongly opposed the introduction of the flat-tax, but their protestations turned out to be in vain. The government actually only presented the proposed tax reform at the roundtable of social partners after it had already been agreed upon by the coalition partners – and any reservations expressed by the trade unions changed nothing in the process (Antalova, 2010). Hence, the outcome of the reform was indeed largely the result of the negotiations among political parties, rather than a reflection of the stronger position held by trade unions in the Czech Republic relative to their Slovakian counterparts. However, what distinguished the Czech neoliberal-led coalition government from the Slovak equivalent was that economic policy making was the result of negotiations among right-wing political parties that actually had *different* positions on economic reforms – not surprisingly, given that socio-economic issues indeed are the main axis of competition and hence the main point at which political parties will engage in programmatic differentiation. In contrast, the neoliberal coalition government in the Slovak Republic – at least until very recently – meant that economic and social reforms were largely a matter of consensus among right-wing parties and that no negotiations on the details of the reforms were necessary.

Welfare state reforms

The shift towards more punitive workfare measures, already apparent at the end of the Social Democratic mandate, was further radicalized during Topolanek's government. The government adopted a comprehensive social reforms package in August 2007. With this, the automatic re-evaluation of existence and subsistence minimum income was abolished and left purely to the discretion of the government. The subsistence minimum was consequently not re-evaluated in 2007, 2008 or 2009, even though the inflation rate in 2007 was 2.8%, and reached a full 6.3% in 2008 – resulting in a considerable decrease in the real value of the subsistence minimum. The bonuses in calculating the living minimum, which had been available for those able to prove the increased costs of job-search, introduced by the Social Democratic government were also cancelled (Sirovatka, 2011).

In September 2008, the entitlements for social assistance benefits were cut again – this time making the recipients eligible to claim the living minimum only in the first 6 months of receiving benefits, while after that they are eligible to receive assistance only up to the level of the subsistence minimum, with the level of support increasing to the living minimum only if they participate in public works for 20-30 hours per month. If they clock up even more than 30 hours they are entitled to an additional bonus. The individual activation plans adopted by Social Democrats were cancelled as they proved to be beyond the capacity of social departments in municipalities and instead Employment Offices were obliged to draw up activation plans with all unemployed person after 5 months of being out of work.

At the same time, reforms were introduced in the administration of unemployment benefits. In September 2008, a new law stipulated that unemployment benefits are provided for a maximum of 5 months for persons below 50 years, 8 months for persons 50-55 and 11 months for persons above 55 – thus one month shorter than before in all three categories. The benefits themselves were however to be increased to 65% of the previous wage in the first 3 months, and remaining at 50% in the next two months and 45% after that. In addition, the trend of rising participation in ALMPs due to the projects from the European Social Fund was reversed and the ESF activities clearly started to be used as a substitute for government spending on ALMP (Sirovatka, 2011). As a result, the reason for more than a quarter of all the unemployed persons leaving the register in 2007 and 2008 was misconduct, while that figure for 2004 was only 11%. The government also introduced a three-track system for parental leave with benefits being higher the sooner a person gets back to work – however, the overall generosity of the system was also cut as even the most generous track still means less benefit than under the previous system with the possibility of 3 and a half years of parental benefits receipt (Saxonberg and Sirovatka, 2009). Furthermore, they have also cut the universal childbirth grant, as well as child benefits, thus introducing more targeting into the system.

In addition, while the CSSD discourse on 'making work pay' resulted in policies that increased the minimum wage, the Topolanek government never increased it. Hence, in contrast with the recommodifying but activist policy of the Social Democrats, the neoliberal government actually turned more towards a cost-cutting type of recommodification.

As for pension reforms, the government introduced parametric changes and it also proposed the introduction of an opt-out option, whereby citizens could transfer part of their social contribution payments from the public to a second, private pillar. Even in this proposal, however, participation in the second pillar was still not supposed to be mandatory, hence still falling short of the radicalism of the Slovak reforms.

Overall, while introducing some cuts aiming primarily at the income protection for the unemployed and recipients of social assistance, the neoliberal government in the Czech Republic turned out to be much more modest in their welfare state retrenchment that their Slovak counterparts. The core of the Czech welfare state was thus still preserved and the generosity of total social spending remained at the same level - 18% of GDP in 2007 and 2008 and rising to 20%, primarily due to economic recession, in 2009 and 2010.

Conclusion

The Czech Competition State started to slide from the high-road towards the low-road in the course of the governments formed by centre-right parties. Still, even in the context of the onset of the global economic crisis, the renewed discourse of austerity and recession in the Czech Republic, there were limitations as to how low it could fall since welfare reforms of the scope and form seen in Slovakia proved to be difficult to implement. The opposition from Czech Social Democratic Party, which announced that it would undo the reforms should it come into power, as well as the disagreements among coalition partners made it impossible to implement radical pension reforms and health care privatization as happened in Slovakia. Attempts to abolish investment incentives also proved to be politically impossible, leading the government to instead reorient and expand the state supports to enterprises, aiming primarily at small and medium domestic operation. The strong and transnationalized state agency, CzechInvest, functioned as an institutional anchor by protecting the activist role of the state in investment and industry supports, even during the reign of otherwise neoliberal parties.

It should be stressed here that the pressure under which the Czech high-road Competition State found itself did not stem from the economic failure of the previous model. To the contrary, the Czech developmental strategy has proved relatively resilient even in the context of the latest crisis. The model was based on dependent industrialization rather than dependent financialization (Becker, 2011) so that its primary vulnerability was the decline of demand in its Western European markets. However, since the main export market for the Czech Republic in recent times has been Germany, which quickly introduced car scrappage schemes and also saw a prompt resumption of economic growth, the Czech economy seems to be weathering the current crisis comparatively well. The rising budget deficit, that was already apparent during the second CSSD government, could have been a matter of concern indicating that the high-road strategy was not sustainable – however, that deficit was partly also the result of the further lowering of corporate taxes that was *not* part of the initial Social Democratic approach. The fact that CSSD is currently arguing for an *increase* in corporate tax rates should they win the next elections shows that it is still possible that the Czech Competition State could, in due time, safely return to the high-road.

The 1998-2006 model was also not exhausted politically. CSSD did not lose the major support of the electorate – it was primarily the corruption scandals that brought down the 2002-2006 government but, after a turnover in the leadership, the party quickly regained support among the electorate and it was only due to the impossibility of building a coalition that the centre-right were able to form another government in 2010. The point is, thus, that a high-road Competition State remains a *politically* viable option, especially when one considers the strong opposition to more radical privatization of welfare services or to the trimming of the public sector among the Czech public.

From the perspective of the Competition State theory, it is most important however that the attempts at more radical reforms that would bring Czech Republic closer to Slovakia were *not* developed as part of the attempts to attract FDI since the country was doing splendidly well in attracting multinationals even without becoming the darling of the World Bank. To the extent that the non-differentiated theory of a single model of Competition State would associate neoliberal social reforms with the race to attract foreign investment, the Czech Republic would certainly disprove the theory – the political orientation towards attracting FDI, and the economic success in doing so, required neither welfare retrenchment nor radical tax cuts. An externally oriented model, nevertheless, did bring about a welfare state that is much more oriented towards commodification rather than decommodification as well as devoting more resources to education and R&D than to the traditional measures of income protection for the poorer social strata. In the context of budgetary pressures, it was indeed the income-maintenance and the support for 'non-deserving' unemployed persons that were either cut or experienced a neoliberal drift during both centre-left and centre-right governments. As much as the goal of redistribution is still maintained in the advocacy of differentiated personal income tax rates, for instance, the fact that all governments turned primarily to increasing VAT when faced with the rising deficit shows that redistribution was still not maintained in the overall tax system. Hence, the relatively generous Czech Competition State should not be identified with the 'old' Social Democratic welfare state as we know it from the mid-20th century Western Europe – rather it is much closer to the political project of the new, Third Way Social Democracy. Nevertheless, it is still rather different from the minimalist Slovak Competition State, oriented primarily towards radical welfare privatization. It is to the development of the latter that I turn in the next chapter.

SLOVAKIA – RACE TO THE BOTTOM

Introduction

Similar to the Czech transformation, the Slovak Competition State also emerged from a crisis of national capitalism at the end of the 1990s. However, as much as the Czech Republic was caught in the neoliberal partial reform equilibrium trap in the 1990s, Slovakia around the same time was an even starker example of the partial reform trap and it led not only to the stalling of further economic reforms, but actually seriously threatened the very existence of democracy in Slovakia. While Czech national capitalism – despite its numerous weaknesses - was still neoliberal *and* democratic, Slovak national capitalism was not only protectionist but also developed in tandem with a competitive authoritarian regime. The two developments – both economic and political – were not independent from one another; as it was precisely the character of the Slovak economic transformation that further undermined its democratic transformation, prevented industrial restructuring and led to the rising current account deficit and currency crisis. Similar to the Czech Republic, thus, transnationalisation appeared in response to the crisis of the late 1990s. However, an important difference is that the crisis in Slovakia was not purely economic, rather it was primarily a crisis of its political regime, with Meciar's anti-democratic practices leading the country further away from the EU and eventually inspiring discontent even among parts of the economic elite that was otherwise benefiting from Slovak national capitalism. The politics of shifting from an internally- to an externally-oriented economic strategy in Slovakia thus happened with elections and political conflicts being fought not around the best strategy for renewed economic development, but rather around the character of the political regime as such, with pro- and anti-Meciarist forces forming the main divisions in the political system. This, in turn, created much less space for divergent economic strategies to appear in the first place so that the neoliberal ideas nurtured in liberal think-tanks and NGOs – working in opposition during Meciar's rule – soon emerged as the hegemonic agenda that not only the right, but also the political 'left', subscribed to.

For many commentators, Slovakia represents the clearest example of what happens to states that are forced to adjust to the fierce race for foreign investment – its flat tax regime, radical welfare reforms, labour law liberalization as well as the individual cases of publicly criticised generous investment incentives, are often seen as the cocktail that best exemplifies the 'second generation reforms' induced by the pressures of globalization. In the following chapter, I hope to modify this image of Slovakia by contrasting its experience with the Czech one. With respect to the combination of policies themselves, I will show that, despite several individual generous deals, the investment incentives granted by the Slovak state were overall much less generous than those in other Visegrad states and were not the hallmark of its competitiveness-enhancing strategy - the fact that there was so much public outcry surrounding them is itself the result of the particular way in which the Slovak Competition State project was shaped and politicized with strong domestic opposition to incentives and the complete lack of a domestic political project that would propose investment incentives as the cornerstone of its economic strategy. Secondly, I will show that the particular set of reforms which Slovakia implemented, and that indeed correspond to the clear-cut World Bank recipes for improving business environment, were not simply driven by the structural pressures of globalization, but rather by developments in Slovakia's own political system that not only fostered the establishment of neoliberalism as a hegemonic economic agenda, rather than only one of many competing programs, but also gave additional leverage to neoliberalism by tying it with the overall goal of Westernization and Europeanization. Overall, the form of the Slovak Competition State, rather than being simply the result of the structural pressures of globalization, is also a reflection of the dynamics of domestic politics and the particular way in which the contradictions of the 'triple transformation' to capitalism, democracy and a new nation-state were resolved. The dual political and economic crisis of its national capitalism, which prompted the emergence of its Competition State, turned out to be much less conducive for the development of an FDI-oriented social democratic agenda than was the case in the Czech Republic. Consequently, the Slovak neoliberal or 'minimalist' Competition State should be seen more as a result of its particular political developments, instead of as the paradigmatic case exemplifying the unavoidable fate of all small FDI-dependent capitalist states.

In order to trace the emergence of the Slovak Competition State, in the first section of the chapter I will deal with what preceded it – namely, the 'crony capitalism' of the 1990s coupled with the semi-authoritarian Meciarist political regime where public support for the regime was initially maintained through materialist compensation in the form of the slow-down of privatization and a relatively generous 'emergency welfare state' (Inglot, 2009: 73). Yet, by the end of the 1990s, the waning public support and the deteriorating accountability of Slovak political institutions associated with its particular mode of creating national 'capitalist stratum' led to the shift of politics from third-order materialist issues and struggles over the course of economic reform to idealist, second-order, politics centered on the character and preservation of democracy in Slovakia. In the second section, I will show how the dual economic and political crises of Meciarist capitalism prompted the shift from a welfare to a Competition State which, in the context of second-order politics and the party system constructed primarily around institutional accountability rather than socio-economic issues, led to a situation of ideational hegemony of the minimalist, neoliberal conceptualization of competitiveness. In the third section, I will demonstrate how the lack of political competition over economic strategies helped keep Slovakia on the low-road strategy of increasing competitiveness even after the change of government and the electoral victory of the new political party closer to the 'left' side of the spectrum.

Building national capitalism - Meciarist era (1993 – 1998)

Introduction

Similar to its Czech counterpart, the rise and fall of Slovak national capitalism can best be understood as a case of the decay of a model that was, in the context of economic openness, clearly not capable of reproducing itself and generating continuous economic growth and political support. Economically, both of these models failed to reinvent themselves in the context of profound economic openness which rendered their enterprises subject to external competition and their currencies subject to the pressures of the international financial markets. However, as opposed to Czech national capitalism, the crisis and the failure of Slovak capitalism occurred not only due to its economic deficiencies, but also due to a domestic political crisis and the fact that the Slovak economic transformation itself threatened to jeopardize political developments in the country and, consequently, its path towards European integration. The complexities and dilemmas of the 'triple transition' (Offe, 1991) thus played out differently in the 1990s in Slovakia than they did in the Czech Republic and it was their resolution that ultimately shaped the crisis of national capitalism and the shift to an FDI-led one, while also simultaneously determining the particular form of each of their Competition States.

Similarly to the Czech Republic, Slovakia initially also opted for a form of privatization that would create national capitalism rather than relying on foreign investors. Furthermore, this national, inwards-oriented economic strategy was also coupled with the preservation of social protection and the welfare state. Although in Slovakia, the 'emergency welfare state' (Inglot, 2009: 73) was not primarily the result of pragmatic concerns or the fear of a popular backlash – as was the case with the Czech welfare state during Vaclav Klaus's time at the helm – but was also backed by the ideological proclamations of the 'Slovak way' constructed as different and opposed to the Czech neoliberalism, the end result in terms of actual policies and welfare state institutions in the 1990s appeared rather similar to the equivalent Czech provisions. However, the rejection of neoliberalism in the sphere of economic reforms and the non-transparent method of privatization led to the creation of 'crony capitalism' with a narrow stratum of winners whose position was entirely dependent on the continued support of the ruling party. Consequently, once the popular support for the government started to wane, the risks associated with a change of government became too high for both the ruling party and the intertwined economic elite, so that the only way in which political and economic status quo could be preserved was through a severe breach of democratic procedures and the profound decaying of the institutions of political liberalism (Gould, 2011).

The political-economic formation of Slovak national capitalism thus fell apart not only due to its economic failure, but also due to its political failure as the legitimacy of the semi-authoritarian regime was increasingly undermined among domestic social groups and in the eyes of external actors, especially the EU. On the domestic side, the fall of popularity of the ruling HZDS and the increasingly vocal opposition led to more clearly authoritarian practices, further damaging the credibility of the regime. Domestic opposition was, however, also linked with supra-national and transnational actors - in addition to the US-financed liberal think-tanks and NGOs, an important role was played by the EU when it excluded Slovakia from the first wave of enlargement. The leverage held by the EU, albeit passive in form (Vachudova, 2005), in turn led to discontent among some national capitalists who were worried about both the potentially worsening conditions for exporting to the West as well as about the implications for Slovakia's standing with financial markets and the knock-on effect this could have for domestic interest rates.

In contrast with the Czech Republic, therefore, the fall of Slovak national capitalism did not lead to stark political competition focused on different *economic* strategies and the ways to foster economic growth via attracting foreign investment. Rather, the dual character of its economic and political crisis of the late 1990s led to the emergence of political competition structured along the axis of political regime and European integration issues. Thanks to the peculiar Slovak path of economic and political transformation, the issue-divides at the core of Slovak politics turned out to be primarily national and regime issue-divides, rather than a socio-economic left-right divide. Consequently, the economic questions of *how* best to attract foreign investment or increase competitiveness, or issues of welfare state preservation vs. liberalization, were very much in the background during the critical juncture of the late 1990s and this resulted in a lack of any clear and coherent different programs of transnational capitalism building. Instead, standard textbook neoliberalism became the only game in town, and it went on to serve as the foundation of the transnational social and economic order in Slovakia.

Creating national capitalist stratum

The first years of Slovakian independence saw a period in power for the Movement for a Democratic Slovakia (HZDS) led by Vladimir Meciar – a period of delayed reforms in the economic sphere and in terms of democratization and political liberalization. Meciar was highly popular in the factory towns of Slovakia, but he still achieved only slightly more than one third of the vote in the 1993 elections. Nevertheless, thanks to the modified proportional representation system and the level of fragmentation among the other political parties, HZDS still managed to obtain a dominant role in the new national parliament (Mathernova and Rencko, 2006).

The establishment of Slovakian independence resulted in a slowdown of economic reforms – in particular privatization. Before the June 1992 elections, Mecias's HZDS strongly attacked all the major elements of the Federal path of economic transformation: restrictive monetary and budgetary policies, privatization including the voucher method, internal convertibility and especially currency devaluation. Once in government, HZDS largely retained the reform strategy it inherited from the previous regime, especially when it came to liberalization, stabilization and a balanced budget – which were thus preserved in the first years of Slovak independence. A substantial reversal of economic policy did, however, occur as regards privatization. After commencing with voucher privatization as part of the Federation policy, privatization was drastically slowed down during the first Meciar government (1993-94). By the end of 1994, only 5 % of Slovak state-owned enterprises had been privatized (compared to 40% of equivalent Czech bodies). Since voucher privatizations were perceived as a Czech invention, the first Meciar government cancelled the second wave of voucher privatization and undertook some direct sales – mainly to the supporters of the governing coalition. Yet, the most important feature of economic reforms during the first Meciar government was the halting of privatizations rather than a decisive turn towards direct sales. The favouritism in the cases of those direct sales that were undertaken, however, contributed to the fall of the government in March 1994 and Meciar's stewardship was shortly interrupted under the temporary coalition government of Jozef Moravcik. Under Moravcik, privatization accelerated briefly with the announcement of the second round of voucher privatizations – the temporary government was eager to use this window of opportunity to push the privatization process as far as possible before the elections (Gould, 2011). However, following the parliamentary elections at the end of September 1994, Meciar returned to government and immediately suspended voucher privatization in 1995. Furthermore, in order to exclude Moravcik's government from direct involvement in privatization, Meciar succeeded in creating a coalition of parties that, at the very first session of the Assembly after the 1994 elections, managed to push through a law that shifted responsibility for overseeing privatizations from the government to an independent privatization agency – the National Property Fund (FNM). At the same time, the executive committee and the supervisory board of the FNM were ousted and new leaders, close to the coalition partners, were selected (Miklos, 1994). The goal was to prevent Moravcik's temporary government from proceeding with further privatizations before the new government was formed by the winning coalition. After this strategic move, privatization continued in the form of direct sales managed by the FNM – and in the majority of cases represented simply the transfer of ownership to individuals with close links to Meciar's party. '*Foreigners who could have introduced capital into the system were virtually excluded from the privatization process, relegating the sale of assets to shady deals with incumbent managers loyal to the government, financed by equally loyal managers of the state banks through soft loans, many of which later became non-performing.*' (Mathernova and Rencko, 2006: 631). Both in domestic circles and abroad, privatization was seen as lacking any transparency and helped create the image of Slovakian 'crony capitalism' (Henderson, 2002).

In contrast with the Czech Republic, where privatization was undertaken largely as a result of an independent act of neoliberalism-inclined technocrats in the ruling party, privatization in Slovakia was much more the result of the influence of the powerful economic elite on state policies. While Meciar's goal was explicitly to create national capitalist stratum, the 'kapitalotvorna vrstva', the creation of such national capitalist stratum cannot be attributed simply to his vision and the autonomous action of state officials – rather it was the result of the economic and political power of the ex-managers of socialist enterprises that simply transformed themselves from the socialist economic elite into the new capitalist class. According to World Bank estimates, by the end of 1996 nearly two-thirds of the shares of assets privatized since independence had been acquired by employees and managers (Appel, 2004: 146). These direct sales, and the creation of national 'kapitalotvorna vrstva' in Slovakia, bear some resemblance to the 'entreprenurial' privatization undertaken in the Czech Republic. However, while in the Czech Republic this 'entrepreneurial' privatization actually attempted to create a national capitalist elite 'from scratch' by promoting a new and previously at best mid-level managers to the top positions of leading industrial enterprises, in Slovakia the new owners largely belonged to the top echelons of socialist economic elite. The consequence is that in the Czech Republic politicians did have links with business leaders, but 'neither group was in the other's pocket' (Myant, 2003: 266) since the managers were not entirely dependent on the state nor were the state officials entirely dependent on the support of the new managers which they themselves installed. In Slovakia, meanwhile, the old economic elite seemed to have the state under its thumb. The linkages between HZDS and the ‘old’ managerial elite – most of whom had already reinvented themselves as new enterprise owners – were apparent in the strong support of the Association of Employer Unions and Alliances (AZZZ) for the government’s policies in mid-1990s. The Association was comprised largely of industrial enterprises and it openly supported the abolition of voucher privatization and the preferential treatment of domestic applicants in the privatization process. Its president, Michal Lach, openly announced that the privatization philosophy assumed by the government has been formulated jointly with AZZZ; furthermore all six ministers of economy during the Mečiar era had also held high positions in AZZZ at one point or another (Mikloš, 1997). By reducing the role of the opposition in the oversight of the privatization process and transferring the responsibility for managing privatizations to the National Property Fund, which had only one (and largely powerless) member of the opposition on its supervisory board, the HZDS government thus largely managed to turn privatization into a process of direct sales to politically connected managers. In 1996, a Slovak MP for the opposition Democratic Union named Viliam Vaškovič warned the Parliament that the NPF frequently used illegal methods to sell shares through the capital market to selected buyers, often costing the state hundreds of millions of Slovak crowns in lost revenue. The government also violated its own law from 1995 which banned the privatization of strategic state-owned enterprises (steel, transport, telecommunication or infrastructure), by selling shares of the oil company Nafta Gbely to an unknown domestic company in a way which also enabled the new owners to pay for the shares from the dividends of the company itself (Mikloš, 1997).

The overall character of Slovak privatization thus resulted in the creation of a small and powerful group of winners whose position was, however, entirely dependent on their political allies continuing in government. In other words, in contrast with the Czech voucher privatization which created a broad class of winners and dispersed ownership, ownership in Slovakia was much more concentrated and the new economic elite had many more direct ties with the ruling political party, all of which threatened the very existence of the democratic political framework and undermined state capacity in Slovakia. Privatization is a fundamental process for the establishment of capitalism as well as for the establishment of a capitalist state because it defines both who the makeup of the new economic elite and how it is related to the state. As Gould (2011) powerfully argues, in a situation where political power is concentrated and privatization has been undertaken in a way that again benefits a small group of well-connected economic elitists, the risks associated with a change to the political elite become too high and it is more likely that the party in government will try to pursue non-democratic procedures in order to remain in power. This is exactly what happened in the course of Meciar’s incumbency, the result being a severely undermined democracy and weakened institutional accountability (Deegan-Krause, 2006), especially during the second Meciar government from 1994-1998, which was a coalition government between HZDS and two much weaker partners in the form of the nationalist SNS and the radical left Association of Slovak Workers (ZRS). According to Deegan-Krause (2006), Meciar's encroachment efforts followed four clear stages:

1.) Legal encroachment (1994-1995), during which he excluded opposition representatives from key parliamentary committees and bodies overseeing executive agencies.
2.) Assertive extra-legal encroachment (1995-1996), during which he used his control of government ministries and executive agencies (now free from opposition oversight) to marginalize and intimidate rival parties and other constitutionally-protected institutions, often through violent means.
3.) Reactive extra-legal encroachment (1997-1998), during which he used the institutional control gained in the first stage to excuse or cover up illegalities of the second stage by pressuring or ignoring prosecutors and judges who sought to impose accountability.
4.) Electoral encroachment (1997-1998), during which the regime used the institutional mechanisms of the first stage to prevent popular fallout by altering ballots, changing the electoral law and otherwise putting pressure on the electoral system.

The result of such a vicious circle of encroachments was that the institutional accountability of the political system in Slovakia was seriously undermined and the county was basically under the rule of a semi-authoritarian regime. Consequently, the issues of democracy and the character of the political regime took central stage in the political arena and became the crucial axis of competition among political parties, shifting Slovak politics from predominantly materialist to predominantly idealistic politics focused on political regime issues (Deegan-Krause, 2006). Building national capitalism in Slovakia thus turned out to be detrimental not only from economic, but also from the political, point of view – an outcome that sharply distinguishes the Slovak experience from that of the Czechs, and one which would have serious repercussions for the development of its transnational capitalism and the distinct type of Competition State.

Welfare state during Meciar

As was the case with their economic policy reforms, the social policy chosen by the first government of the independent Slovakia was conceived in opposition to the more neoliberal direction of the Czech approach to transition. Meciar thus opted for what he labelled 'the Third Way,' which represented a specific version of the social-democratic ideology of social solidarity with a strong preference for corporatist governance. At least rhetorically, it emphasized the role of trade unions in the large industrial sector (Meciar's main constituency) as well as in the public sector. The egalitarianism and social solidarity which formed the cornerstone of Meciar's rhetoric meant that the new Slovak welfare ideology emphasized both traditional social insurance, i.e. pensions, as well as family benefits and social assistance for the poor (Inglot, 2009). Nevertheless, given that the Czech neoliberalism was far from being actually implemented in the social policy area, the Slovak welfare state institutions actually remained very similar to the Czech ones.

The newly independent Slovakia had inherited the republican branch of the Czechoslovak Social Security Agency, which was then transformed into the National Social Insurance Agency and granted independent status under a tripartite board, chaired by the Minister of Labour, Social Affairs and Family. The financing of social insurance was based on three separate funds – pensions, health and sickness – until 1995, when the Agency split into two different bodies: the Social Insurance Agency dealing with pensions and sickness insurance, and the Health Insurance Agency, covering health care. As opposed to the Czech Republic where, despite the principle of social insurance which had already been declared in the Czechoslovak Scenario for Social Reform, pensions remained in the state budget, in Slovakia the government actually did establish independent bodies governed by a tripartite board. With respect to pensions, the government undid some of the reforms implemented during the Czechoslovakian Federation era - for instance, it restored the three categories of workers in pensions system (Lesay, 2009). At the same time, it did not introduce any of the parametric reforms apparent in the Czech system nor was pension formula adjusted for economic growth or inflation, meaning that any modifications to reflect changing living standards were done by separate decrees, usually every year or sometimes twice a year. The separation of pensions from the state budget was done primarily with the aim of achieving greater transparency in the system and preventing the state from using the surplus in pension account which resulted from the relatively high social contributions. The move towards greater independence of the pension system was not, however, successful – precisely because the government knew that there was surplus in the system, it simply stopped paying contributions for its own insurees – students, the unemployed, etc. The result was a substantive deterioration in pension finances which started to show a deficit from the mid-1990s onwards – and from then on it became commonplace to talk about the problem of the deficit in pension finances, even though it had very little to do with demographic developments and was rather the result of state misconduct (Lesay, 2009).

A similar situation was apparent in the administration of sickness insurance – an independent body was established and the financing and expenditure were separated from the general state budget. However, the state was again prone to ignoring its obligations and reneging on its contributions for its insurees, thus creating a deficit in the Fund of Sickness Insurance (Potucek and Radicova, 1997).

Following the path already established during the Federal era, Slovak employment policy was based on emphasising active labour market policies; however, over time, the efforts at activation decreased, with the level of participation of unemployed persons in active labour market programs declining from 51% in 1991 to 21% in 1996. The fall in the Czech Republic was, however, even more pronounced: from 38% to 12% in the same period. Furthermore, a long-term substantial decrease in the replacement rate of unemployment benefits compared with the average wage was also a common development in both states. The principle of establishing independent institutions governed by tripartite boards was respected in case of labour market policies in Slovakia as well, with the establishment of the National Labour Office in 1996.

Overall, the first years of the Meciar government showed broad continuity in Slovak welfare state efforts, particularly when it comes to family policy that was already well developed and important during the socialist era. Thus, while some retrenchment was implemented in the context of high unemployment and the dire overall economic situation, it concerned primarily pensions, while family and maternity allowances remained relatively generous (Inglot, 2009). This stance, however, began to change in 1995-1996 when the economy began to slow down again and after Meciar experienced his first political defeat in 1994. Fearing industrial unrest and the dissatisfaction of the core constituency of HZDS, welfare priorities were reconsidered and channelled away from family benefits – with child allowance remodelled on a means-tested basis instead of a universal system in 1994 (Inglot 2009). Nevertheless, by 1995 Slovak welfare state generosity was still on a par with the other Visegrad states – and its social expenditure as a share of GDP actually increased from 18% in 1995 to 20% in 1998.

The rising social expenditure, however, soon contributed to the country's deteriorating macroeconomic stability. Initially, the fiscal policy of Meciar's government was actually quite tight, but from 1996 on Slovakia ran a higher budget deficit (spiking at 8% in 1996). This money was used to finance not only the welfare state, but also certain public work and large public investment projects, which triggered substantive criticism from the opposition leader Dzurinda. Indeed, many commentators argued that public investment was channelled primarily into the politically-connected defence and construction industries (Fisher et. al, 2007).

In the context of a rising budget deficit, the government reverted to increasing taxes. While the Parliament had, as recently as 1995, reduced the VAT rate from 25% to 23% and expanded the range of goods subject to the lower VAT rate, mores changes came in 1997. This time the Parliament added some basic items into the lower bracket (6%), while at the same time also pushing certain services that were previously subject to only 6% VAT into the higher bracket – namely, telecommunications, consultancy, and financial and insurance services (The Slovak Spectator, 1997a). Nevertheless, the above measures were not enough and the deficit continued to rise in 1998, although the government excluded the servicing of their principal foreign debts from the deficit figure (The Slovak Spectator, 1997b). Corporate income tax, on the other hand, remained fairly high in this period, with a rate of 40%. Thus, the overall picture of the fiscal system under Meciar is one of lower VAT and higher corporate tax rates – precisely the opposite of the system designed by subsequent governments.

Overall, and similar to the parallel developments in the Czech Republic, the period of national capitalism in Slovakia was marked by welfare state stability and the preservation of the institutions established during the early post-socialist years of the Czechoslovak Federation. Despite different rhetoric and completely different political ideologies in the two countries, with neoliberals in the Czech Republic and more protectionist and populist leftists in Slovakia, their social policies remained very similar as in both cases an 'emergency' welfare state served as an important instrument for maintaining public support for the overall project of economic transformation.

Slovak de-democratization – party-system development in competitive authoritarianism

As opposed to the Czech party system, which very soon crystallized around the socio-economic cleavage, from the very beginning the Slovak system took on a different structure. To a certain extent, this development could be attributed to the different political legacy of the socialist experience, in particular the difference in the 'normalization' period of Czechoslovak socialism where Slovak reformists were co-opted by the Communist party rather than turned into dissidents. The association between the political legacies of socialism and the subsequent development of party systems figures particularly prominently in the account of Kitschelt et al (1999), which tentatively places Slovakia in the patrimonial communism type. However, the mode of co-optation of the Slovak reformists during the 'normalization' period actually places Slovakia closer to the national-accommodative regime seen in Hungary and Poland, rather than the patrimonial regimes of Bulgaria and Romania (Deegan-Krause, 2006). Furthermore, as Deegan-Krause correctly notes, the transformation from socialism was not orchestrated by the Communist party, as was the case in other countries emerging from patrimonial communism, but was rather captured by the nationalist movement. Hence, the reasons for the different structuring of the Slovak party system should be sought out in the agency and strategies of the political actors – notably Meciar's successful deployment of the national and independence issues - rather than in different historical legacies. A precise account of the main reasons for the political divergence of the Czech Republic and Slovakia is not, however, the aim of this thesis. Rather, what is relevant for my argument is that the main issue divide structuring the Slovak party system in the first years of national independence, and indeed even during the Czechoslovak Federation, turned out to be a clash over national independence – with Meciar's HZDS and the nationalist SNS being pro-independence and other parties maintaining a more ambivalent stance – which was reproduced in the attitudes of the voters (Deegan-Krause, 2006). After obtaining independence, the dominance of the centre-periphery cleavage at the Prague – Bratislava level ceased to be the main line of conflict in the newly independent Slovak political system for obvious reasons. Nevertheless, the nationalist cleavage turned to *other* issues pertaining to national identity – notably, the stance towards the Hungarian minority as well as the attitude towards the EU. In this respect, HZDS and SNS were again found in the pro-nationalist camp, with the voters following the parties' attitudinal shift. Thus, while in 1993 a survey of HZDS voters showed that they distrusted the EU to the same level as everyone else, by 1996 their distrust had risen to 10 percentage points above the population mean, and in 1999 the gap reached 20 percentage points (Deegan-Krause, 2006: 205) – not surprising, given the increased criticism of the EU directed at the political regime in Slovakia.

Still, while a nationalistic cleavage dominated Slovak politics in the beginning of the 1990s, it was gradually overshadowed by another cleavage which henceforth constituted the main axis of polarization of Slovak politics – one centred on the very character of the political regime. Meciar's practices, which corresponded much more to a 'competitive authoritarian regime' model rather than a liberal democracy, soon led to a situation where the issues of democratization and the rules of the political game itself became the main defining feature of the conflict among political parties. (The decline of the nationalist cleavage is also visible in the fact that, by the end of Meciar's rule, even a coalition with the Hungarian party became possible at the national level.) Throughout the 1990s, Slovak politics was thus dominated by the conflict between proponents of liberal democracy, on the one side, and the non-liberal ruling party on the other - a conflict usually described in Slovak political science as Meciarism vs. anti-Meciarism or, in Deegan-Krause's (2006) terminology, the institutional accountability issue divide. Hlousek and Kopecek (2008) distinguish three stages of the development of this cleavage. The first, crystallization stage, began with the first signs of the disintegration of the VPN as early as the Federation era and lasted until 1994, when some dissatisfied members of the HZDS's coalition partner, the nationalist SNS, left the party leading to the loss of parliamentary support for the government. The second stage, escalation, starts during the short-lived coalition government under Prime Minister Moravcik in 1994. The new governing coalition was a very heterogeneous alliance of parties united primarily by their opposition to Meciar and it consisted of the centre-right anti-communist KDH and the ex-communist SDL. However, Meciar used his brief stay on the opposition benches to successfully mobilize the voters and emerged victorious in the irregular election of autumn 1994, creating yet another heterogenous coalition with the radically right SNS and the radically leftist Alliance of Workers of Slovakia (ZRS). The main dividing line between these two unlikely coalitions was, thus, the question of whether they were willing to accept Meciar's style of ruling. This style indeed included numerous breaches of democratic procedures, such as the attacks on the president Michal Kovac (including being involved in the abduction of his son) or the unconstitutional deprivation of the parliamentary mandate of a former HZDS member, Frantisek Gaulieder. During his second mandate, Meciar continued to ignore democratic procedures also with respect to the choice of privatization method and expedited the transfer of state property into the hands of his political allies. This created a concentrated group of winners whose economic power and position was entirely dependent on the continued rule of HZDS, which further facilitated his need for unconstitutional dealing with the political opposition (Gould, 2011). Hence, the political developments of the 1990s and deterioration of institutional accountability under Meciar contributed to the strengthening of the political regime cleavage.

The survey data on the attitudes of parliamentary deputies towards 'firm-hand rule' in Slovakia and the Czech Republic indeed show that, as early as 1994, the divisions separating coalition partners in Slovakia were much more based on their positions towards institutional accountability than was the case in the Czech Republic, where the governing coalition included parties more prone to supporting the 'firm hand' of the government alongside those with more politically liberal positions (Deegan-Krause, 2006: 108). Similarly, while in the Czech Republic survey data shows that, over time, voters of right or left wing parties developed more polarized opinions on economic issues throughout the 1990s, Slovakia experienced a compression of the relative positions of party supporters on economic issues and a weakening in the relationship between economic attitudes and party choice, while recording an increasing association between party choice and support for the 'firm-hand' rule (Deegan-Krause, 2006).

In terms of party system development, thus, the second-order political regime cleavage strengthened in the course of Meciar's rule, with the opposition parties creating a coalition before the 1998 elections and mobilizing a large campaign in favour of the liberalization and democratization of the country. As will be described in the following sections, they were largely successful in this; however the Meciarism vs. anti-Meciarism cleavage continued to dominate Slovak politics for a large part of 2000s as well. Although the erosion of this cleavage had arguably already begun in 2000 (Hlousek and Kopecek, 2008), the fact that the coalitions formed in both 2002 and 2006 largely revolved around the parties' willingness (or lack thereof) to cooperate with the new party that had taken over HZDS's electorate, as well as that of its economic allies, shows that some traces of the Meciarist legacy were still discernible in the Slovak party system even after democratization had been fully achieved.

The Meciarim vs. anti-Meciarism cleavage was apparent not only among political parties, but also among the electorate in the 1990s – those who supported the parties of the Meciar's coalition were typically more in favour of the abuses of the rule of law, were more likely to display authoritarian attitudes, and were more positive in their assessment of the socialist period, while in terms of socio-demographic characteristics they were typically less educated and lived in villages or small towns. On the other hand, the supporters of the anti-Meciarist coalition were more tolerant towards minorities, less authoritarian, more educated and largely living in the cities (Hlousek and Kopecek, 2008). It is also important to note that socio-demographic profiling of the political parties in Slovakia only took place in the second half of the 1990s. While in the 1992 and 1994 elections the electorate of the ruling HZDS had the same socio-demographic characteristics as the majority of the population, in the 1998 elections it shifted towards above-average aged voters, people with lower education, workers, pensioners and voters from rural areas. The electorate of SDK was, on the other hand, the mirror image of the HZDS supporters: younger, better educated, professionals, entrepreneurs and students (Gyarfasova and Krivy, 2007).The end result of this was, however, that differentiation among political parties took place primarily with respect to questions of democratization and the character of the political regime, rather than socio-economic left-right divisions. As Meseznikov put it in 1998: '*The difference between government and opposition parties are particularly visible on the level of their distinct understanding of democracy (authoritarianism vs. liberalism, conflict politics vs. consensus politics and preference of the values of the individual vs. elevating the interests of a collective entity.*' (Meseznikov, 1998: 93). Consequently, once the support for the Meciarist regime became seriously undermined, both because of its increasingly blatant breaches of democratic procedures as well as its detrimental effect on the chances of Slovakia being admitted to the EU, the forces that managed to bring about regime overhaul were united in their opposition to Meciar and in their agenda to join the EU, but their economic programs were much less developed and elaborate.

The fall of Slovak national capitalism

Despite numerous problematic political developments in Slovakia during Meciar's incumbency, the country at the time recorded relatively good economic growth. In comparison with their Polish and Hungarian neighbours, there was actually some talk of a Slovakian economic miracle, despite the very low levels of foreign investment. That said, this growth was actually primarily driven by increases in domestic demand and the large public works financed by the government, and it was clearly not sustainable – leading to an average current account deficit of 9% in the years 1996-1998 (11% in 1998) accompanied by a government budget deficit of almost 6%. Furthermore, growth was not accompanied by falling unemployment, as the unemployment rate consistently remained above 10% in this period. Hence, despite talk of an economic miracle, the Slovak economy suffered from a weakness similar to that of the Czechs – its method of privatization and the tacit support of the state for failing enterprises failed to bring about either enterprise restructuring or a successful reorientation towards exporting to Western markets. Coupled with trade liberalization, this led to the rising twin deficits and pressure on Slovak koruna, as well as unfavourable terms for Slovakia in raising foreign debt. In March 1998, citing their high fiscal and current account deficits, Moody's downgraded Slovakia's foreign-denominated bonds to 'Not Prime', while six months later Standard and Poor's cut Slovakia's credit rating from lowest investment grade to speculative levels (The Slovak Spectator, 1998a). As a result, Meciar's government was pressed to borrow under extremely unfavourable terms, leading to interest rates spiking at 30% in the last year of Meciar's government. Hence, after the electoral defeat of Meciar in 1998, it turned out that the Slovak miracle was largely due to 'reckless borrowing' and, when the National Bank of Slovakia switched from a fixed to a floating exchange rate on 1 October 1998 (within a week of the elections), the currency slumped by 17%, while in the same year the unemployment rate rose from 12 % to 16 % (Henderson, 2002). Meanwhile, the new government cancelled many of the public works schemes that were helping keep unemployment below 12%, which meant that by 2002 the unemployment rate had risen to 19%; though inflation dropped from 5.2% in 1998 to 3.4% in 2002.

Thus, similar to the exhaustion of the Czech neoliberal national capitalism, Slovak crony capitalism also seemed to be unable to reinvent itself. Starting from 1996, the Slovak 'economic miracle' found itself in crisis, with increased foreign borrowing, the downgrading of state bonds, the koruna under pressure, and a rising share of non-performing loans threatening to cripple the banking sector. The troubles of failing enterprises were initially met with government bailouts – the 1997 Revitalization Law allowed the government as well as state-owned banks to forgive debts of large enterprises. December 1997 also saw one of the major banks – Investicna a Razvojova Bank – placed under forced administration due to its liquidity problems. However, with the emerging banking crisis and the continuous downgrading of Slovakia's bonds raising the cost of government borrowing, the bailout strategy could obviously not work in the long run. Furthermore, given the extremely high bond yields that the government was forced to accept (The Slovak Spectator, 1998b), it is no wonder that the government started to make concessions to the international financial community, such as abandoning proposed amendments to the law on the National Bank that would have given the government more influence over it, as well as eventually offering tax breaks to foreign investors in a desperate attempt to gain access to foreign capital on July 1 1998. The move was justified by the government's claim that it would help reduce the current account deficit and boost exports and foreign investment (The Slovak Spectator, 1998b). Similar to the developments in the Czech Republic, the crisis of national capitalism prompted even the political elites that were presiding over nationally oriented privatization to change their attitude and become more open to FDI. Furthermore, Meciar's policy of high public investment and rising debt led to interest rates becoming so high as to restrict domestic companies' access to financing. '*If Mečiar continued, I have no idea what the companies would have done or how they would have been financed. Because interest rates for companies were about 20% per annum, which is enormous money, and it was going up and up. So when Dzurinda came and introduced the first savings programmes, increasing the rating of Slovakia and opening it up to foreign markets, the interest rates went down and the price of money decreased - and this was very good for entrepreneurs in Slovakia.*' (Gregor, interview).

However, in contrast with the Czech Republic, the economic crisis was in Slovakia was also coupled with a political crisis and the increasingly authoritarian practices of the ruling coalition. The latter led to the deterioration of the Slovak position on the international stage – due to their failure to fulfil the political aspect of the Copenhagen criteria, Slovakia was denied accession to the EU at the Luxembourg Summit in 1997. This further undermined the support for Meciar's regime – acting as the 'passive leverage', the EU's denying accession to Slovakia sent a strong message which further strengthened the political opposition to Meciar (Vachudova, 2006) and also prompted reactions from the business elite close to Meciar that was counting on the expansion of trade with the EU (The Slovak Spectator, 1997c).

The opposition parties hence decided to join the forces in the upcoming elections and organized themselves in a broad coalition which spanned from the leftist PDL to the right wing SDK. In addition to this, even Meciar's coalition partners – the Slovak National Party (SNS) and the Association of Slovak Workers (ZRS) – turned against the government and opposed both the budget proposed for 1998 as well as the law on the National Bank of Slovakia. The political opposition was apparent not only among political parties, but also within civil society, with numerous think-tanks and NGOs such as MESA 10, the F. A. Hayek Institution, Centre for Economic Development, Institute for Public Affairs and many more attacking the 'political statism' of Meciar's government (Fisher et. al, 2007). The flourishing of Slovakia's think-tank scene happened to a large extent thanks to Meciar's purging of experts from academia and the state administration. These new 'dissidents' thus established their small analytical centres which subsequently attracted another experts from academia (Meseznikov, interview.) As Meseznikov recalls, the conditions in think-tanks were relatively good at the time and these organizations were actually the only reliable sources of analysis. *'The country was basically under authoritarian rule. The Slovak Academy of Science was not participating very actively in public debates in those years, nor did they elaborate the policy proposals which were needed at that time. Not only to analyse, but also to publicise and to give to the public an idea of what the situation was like and to make them realize that there were real alternatives. That was the role of think-tanks at the time.*' (Meseznikov, interview). Due to the authoritarian character of the government, liberal and pro-democratically oriented intellectuals joined the ranks of the political right.

The core concept around which the opposition organized was 'liberalism' – referring to both liberalization of media and the strengthening of basic democratic institutions, as well as economic liberalism or, more precisely, neoliberalism as a template for policy reforms. The result of this large scale mobilization against Meciarism was a record 84.4% turnout at the elections in September 1998, with Meciar's HZDS indeed being ousted from power, leaving a new coalition to organise the first post-Meciarist government.

The initial response to this crisis was thus the same in both Czech Republic and Slovakia – after the failure of national capitalism to reproduce itself (Drahokoupil, 2009), attracting FDI indeed appeared as the only solution even to those politicians who were initially staunchly opposed to it. Furthermore, in both cases, the crises manifested in the form of a currency crisis and increasingly unfavourable borrowing conditions on the international financial markets – thus indeed differentiating the experience of Czech Republic and Slovakia from the experience of states that were shielded from these pressures thanks to their participation in the common European currency. However, the politics of shifting towards FDI and the politics of the crisis of national capitalism turned out to be fundamentally different. In the Czech Republic, on the one hand, the main issue divide remained socio-economic issues and the 1998 electoral campaign revolved primarily around a choice of different strategies and methods on how to build transnational capitalism. In Slovakia, meanwhile, the details and nuances of economic strategies and debates on different forms of competitiveness could not have been further from the thoughts of the electorate and the political parties. Rather, the core of Slovak politics was constituted by an accountability issue-divide and the elections of 1998 amounted to a plebiscite on joining the EU and restoring or establishing liberal democracy.

Conclusion

Similar to the Czech Republic, Slovakia's first years of independence combined efforts at building national capitalism with preserving a large part of its welfare state. Despite the fact that the Czech Republic was then governed by neoliberals, while Slovakia was governed by a self-proclaimed Left party, their welfare policies were by and large similar. Just as Klaus did not radically retrench the Czech welfare state, nor did Mečiar expand Slovak social spending to areas that were not strong during socialism – such as unemployment or social assistance benefits. Rather, the core of the pension system, health care provisions and family policy was preserved, while the traditionally weak income-protection of unemployed persons did not get any stronger.

Still, the strategy and political agenda of building national capitalism were radically different in these two countries, and these differences bear important impact on their respective shifts towards transnational capitalism. Whereas Czech national capitalism created dispersed owners with cross-cutting interests and political alliances, the Slovak equivalent spawned a concentrated group of winners with strong ties to the ruling political party. Both of these national capitalisms had similar economic weaknesses: lax corporate governance regulation; cross-ownership with conflicting interests between banks as owners and banks as creditors; widespread opportunities for 'tunnelling', the lack of incentives for economic restructuring leading to deteriorating terms of trade and a resultant negative balance of payments and currency crisis in both countries. Nevertheless, there were profound differences in the *political* implications of these two national capitalisms: while in the Czech Republic economic decline was indeed possible, but political developments and democratic rules of the game as well as institutional accountability were by and large safe, in Slovakia the concentration of the privatization winners and their alliance with the ruling party created strong incentives for the ruling elite to turn towards an authoritarian style of government which seriously undermined institutional accountability. The result was a profoundly different structuring of political and party systems in these two countries, with the Slovak one centering primarily on the issue-divides of national identity and procedural democracy questions so economic issues and economic debates were increasingly pushed into background. As will be seen in the next section, this difference in political and party system structuring had important consequences for the range of economic strategies and programs which emerged in Slovakia in the course of its economic transnationalisation. In contrast with the Czech Republic, with its different programs for attracting FDI and pronounced debates over what constitutes competitiveness and how it is to be achieved, the Slovakia political system developed in such a way that only *one* economic program became associated with continued democratization and joining the EU – namely, the political program of textbook neoliberalism and the minimalist, low-road Competition State. The shift from national to transnational capitalism in Slovakia thus represented the process of both political and economic change which was far from conducive to the development of different strategies for increasing competitiveness and managing the insertion of national economy into global markets. The result was the adoption of a low-road strategy for increasing competitiveness and the emergence of a markedly neoliberal, minimalist Competition State which made Slovakian policies much more similar to the Baltic or Balkan states, or indeed the Irish Republic, than to the rest of the Visegrad group.

Creating an 'investors' paradise' – the Slovak neoliberal Competition State

Introduction

The 1998 elections were certainly a turning point in Slovak history. The turnout at the elections was 86% - more than in any elections since the fall of Communism – and for many commentators they represented a delayed Slovak awakening to democratization, a second revolutionary moment after the elections of the 1989. What was at stake, as opposed to in the Czech Republic, was not simply the changing of a government that had failed to bring about transparent privatization and economic growth, it was rather democracy itself that was seen as being in jeopardy and the exceptionally high turnout was primarily read as reflecting the citizens' wish to see a profound change in the political course the country was taking. Rather than debating the best ways to get out of the economic crisis, the elections were essentially about turning to the West, joining Europe and NATO, as well as democratizing the country. Not surprisingly, the results brought defeat for Meciar and a large coalition government led by Mikulas Dzurinda took power. However, the questions that decided these elections – democracy and political regime issues, referred to here as second-level politics – continued to dominate Slovak politics and structure the basic divisions and conflicts in the Slovak political landscape for many years to come.

The joint political and economic crisis of national capitalism in Slovakia thus resulted in a resolution whereby political legitimacy was sought largely on the grounds of political regime issues, rather than economic ones. Consequently, rather than giving rise to competing programs of transnationalisation, a neoliberal program of tax and welfare cuts was accepted as the only agenda compatible with Westernization and Europeanization. It was precisely the unreserved pro-Europe nature of the neoliberal party and the citizens' support for EU accession that secured sufficient electoral support for the right-wing parties in the wake of accession to the EU in 2002 elections. This enabled the formation of a clear-cut neoliberal government which set the foundations of the Slovak Competition State and, furthermore, steered it in the low-road direction. The elections of 2002 were, to a large extent, another step on the European path and were a continuation of the ambitious reform agenda that was framed as one of modernization and Europeanization vs. jeopardizing this path by voting for HZDS. Indeed, HZDS appeared as the winner in the elections, but the anti-Meciarist stance of most other parties, as well as the fear of turning away from the EU integration track, meant that it could not form a coalition. Rather the 2002-2006 government was again formed by Mikulas Dzurinda and represented a coalition of Dzurinda's SDKU, Hungarian SMK, Christian Democratic KDH and a new liberal party called ANO. The 'left' side of the political spectrum was, on the other hand, very much in disarray: HZDS maintained relatively centrist economic positions; the post-Communist SDL was compromised by its participation in the coalition government and soon dissolved amidst internal conflicts between the left and right factions in the party; while the newly emerging Smer, whose leader Robert Fico had spun off from SDL, also developed a more centrist and less coherent economic position by placing itself above the left-right divide and campaigning more on issues such as corruption and 'law and order' than on leftist redistributionist policies.

In the absence of any alternative economic agenda, the notions of competitiveness and attracting foreign investment could be framed in a textbook neoliberal fashion in Slovakia – and this neoliberal understanding gained hegemonic ideological position, rather than, as in the Czech Republic, being challenged by a competing agenda based on New Growth economic theories. While in the Czech Republic both the Social Democrats and neoliberals based their economic programs on the notions of increasing competitiveness and attracting foreign investment, but went on to develop different understandings and policy recipes of how this should be achieved, neoliberal economic ideas were in Slovakia essentially uncontested since the main role of the opposition turned out to be acknowledging that these reforms are painful for the people and should thus be complemented with certain social measures, such as maintaining lower VAT on food and medicine or granting Christmas bonuses for pensioners. In contrast with the Czech Republic, the left agenda in Slovakia did not include a program of active industrial policies and generous investment incentives – instead, the party that emerged as the strongest on the 'left', Smer, was the first to criticise the generosity of certain individual deals between the government and foreign investors. Similarly, the 'leftist' agenda did not include any strong opposition to welfare privatization either, but rather remained focused on technical details such as the exact ratio of mandatory contributions to the private vs. public pension pillar. Overall thus, while the neoliberal ideas of a small state, flat-tax and a business friendly environment can be found in both Slovakia and the Czech Republic, only in the latter did they face competition from another set of ideas that also based economic development on openness to trade and foreign investment but deployed a different understanding of development and proposed different instruments for achieving it.

Towards the hegemony of neoliberalism – the politics of Slovak Competition State

The big anti-Meciar coalition government of 1998 comprised SDK (Social Democratic Coalition - itself a coalition of several parties), SDL (Party of Democratic Left, the reformed Communist party), Party of Civic Understanding (SOP) and the Hungarian Coalition Party (SMK), with the prime minister Dzurinda coming from the Christian Democratic party that was part of the SDK coalition and the Deputy Prime Minister for Economy Ivan Miklos coming from the Democratic Party, the most liberal of the SDK coalition. Hence, the government actually included a large number of parties united by the goals of ousting Meciar from power and joining the EU, but covering a large span of left-right positions, from the post-communist SDL to the radically neoliberal Democratic Party (DU), part of the SDK. Such a coalition was possible precisely because the main line of political conflict did not run between socio-economic left and right poles, but was rather focused on issues pertaining to institutional accountability and the functioning of Slovak democracy, as well as its prospects of joining the EU. The main division – both among political parties and among the electorate - was thus the one between political liberalism on the one side and authoritarianism on the other side (Gyarfasova and Krivy, 2007). The elections of 1998 were indeed perceived as the second democratic awakening of Slovakia, the point at which the competitive authoritarian regime of Meciar was finally succeeded by a government of parties all committed to the basic principles of democracy. However, such a pattern of political conflict was not conducive to the development of different political agendas and different strategies of economic development. Rather, the parties were campaigning and positioning themselves primarily with regards to their opposition to Meciar and his authoritarian practices, as well as promising to put Slovakia back on the fast track to EU accession. Providing a decisive break with Slovakia's Meciarist past, both in terms of political and economic policies (referring primarily to Meciar's privatization strategy), was thus the main common denominator of the coalition of parties succeeding Meciar, while the details of the economic strategy were more varied and much less specified.

The post-communist SDL, which at the time represented the left pole of the anti-Meciar coalition, maintained a rather vague economic position. While it clearly campaigned for a 'social market economy', it was much less clear on its position towards foreign investment. The emphasis was rather on advocating various 'democratic' forms of ownership, including social and communal ownership, employees' shareholdings, as well as maintaining state ownership in strategic sectors – and, while it saw the need for an active role for the state in supporting exports and the competitiveness of local industry, this role was seen primarily in terms of supporting domestic companies, rather than actively luring foreign investment (SDL, 1998). The other parties of the coalition – Hungarian MKDM as well as the SDK members KDH and DS – were more open to foreign investment, accepting it without qualifications, while SNS was adamantly opposed to it. Meciar's HZDS, on the other hand, declared themselves to be in favour of it, but still made many statements that actually showed hostility towards FDI (Deegan-Krause, 1998). The public opinion also followed the party differentiation: while SDL voters moved from opposing FDI in 1992 to approaching the population mean in 1998, KDH and DU voters supported it more keenly than the average, while the supporters of SNS and HZDS became ever more strongly opposed to FDI (Deegan-Krause, 1998). In short, while in the Czech Republic by the end of the national capitalism era a consensus had emerged that foreign investment was *the* solution to the national economic problems and the debate shifted to the question of how to attract it, in Slovakia the unreserved support for FDI was primarily the position of the political right. Not surprisingly, the question as to how to attract foreign investment thus received only one – decidedly neoliberal – answer.

Consequently, even the presence of a left-wing party in the coalition government, with its close ties to the trade unions, did not mean that the government would automatically pursue a high-road strategy for increasing competitiveness since such a strategy was not a cornerstone of the left political program to begin with. Rather, the coalition government was actually more focused on restoring macroeconomic stability, restructuring and privatizing the banks, establishing bankruptcy laws – all reforms that represented primarily the creation of a framework for a 'functioning market economy' - while a more radical neoliberal set of reforms, proposed by the advocates of FDI in the government, were stalled by the opposition from PDL and had to wait for the next government. The neoliberal agenda of attracting FDI and increasing competitiveness was apparent in the Czech Republic as well – however, in the Czech Republic the neoliberal view was challenged by a competing Social Democratic program of increasing competitiveness through active state support for selected investments, as well as through increased spending on education and active labour market policies. In Slovakia, nothing like that happened. During the first coalition government, the left-wing SDL was indeed opposed to some of the harshest cuts advocated by their coalition partners, but they were unable to prevent them. Importantly, they were equally unable to come up with a different and coherent economic program featuring a different strategy for increasing the competitiveness and success of Slovak economy in the global market.

Hence, the focus on institutional accountability and the mode of political regime, rather than socio-economic left-right issues, in the crucial years of the Slovak turn towards transnational capitalism building left two important marks on Slovak politics which would have consequences for the form of its subsequent Competition State. First, due to its participation in the anti-Meciar coalition government, the post-communist PDL – which represented the left pole of the coalition – was substantively weakened and, after its failure in the next elections of 2002, it actually seized to exist in 2004 by merging with Smer. According to Haughton (2004) the main reason for the failure of SDL was its participation in the short technical government of Moravcik (1994) and SDKU 1998-2002 coalition where, in both cases, it took the portfolio of the Ministry of Finance – meaning it was seen as responsible for the unpopular cuts introduced by these governments. Their participation in coalition government only sharpened the conflict between the 'traditionalists' and 'modernisers' in the party – or, put differently, between the more leftist and more conservative wings of the party. These tensions also prompted Robert Fico's departure from the SDL to form Smer in 1999, which took away significant public support from the SDL. The SDL was further damaged after the party leader publicly called for the resignation of Brigita Schmognerova from her post of the Minister of Finance. This incident contributed to a further split of the party in 2002 and very low electoral support for both SDL and its splinter parties in the elections later that year. Indeed, SDL did not even make it above the 5% threshold for the parliament which meant that the main Slovakian left party was not represented in the parliament from 2002 to 2006. Hence, the salience of anti-Meciarism produced not only an ideologically incoherent coalition government in 1998-2002, but was also played out in the profoundly divided leftist camp during the second government of 2002-2006. Parliamentary opposition thus consisted of HZDS, the Communist Party of Slovakia (elected to the parliament for the first time since 1990) and Fico's new Smer party. None of these parties posed any coherent opposition to neoliberal reforms – Meciar's HZDS was too busy reinventing itself after its illiberal past, as well as handling further splits of the party; the Communists criticized but were far from offering alternative proposals; while Smer similarly offered criticism, but could not prevent reformist policies from taking place.

Among these parties, it was Smer that positioned itself as the main critique of Dzurinda's reforms, and soon became the main 'left' party. Quotation marks are however needed when speaking about Smer as a 'left' party. It initially proclaimed itself as 'center' and 'beyond left and right', only later to position itself as a Blairist 'Third Way' type of Social Democratic party and leftist defender of the 'small people'. Smer's turn to the left happened only in 2004, largely in response to the radical neoliberal policies of the ruling coalition which it could then criticise from a more leftist position. The shift and the crystallization of its leftist identity was also signalled by how it changed its name into 'SMER – Socialna Demokracija' at the end of 2004.

However, they offered little in terms of an actual economic program that would be different from the neoliberal one; rather, their approach was the one of both ‘necessary reforms’ and social concerns. The experts would, on the other hand, usually classify Smer as centrist populist (Ucen et. al., 2005) due to its appeal to the small people vs. the corrupt elite, which is however not coupled with any radical economic agenda. Furthermore, the origin of the party seems to be quite far from the ‘little people’ – experts actually identify Smer as simply the invention of the business elite close to Meciar that found themselves without political protectors once HZDS lost its grip on power. As Meseznikov put it: ‘*Smer was formally established by Fico but de facto 6-7 persons, formerly Meciar’s privatizers, were behind this party. They realized that they were finished with Meciar, Meciar was no longer a political vehicle for their economic amibitions, centre-right parties would reject them, so they needed some alternative vehicle and Robert Fico played this role and quite successfully. They are not real Social Democrats - they have some left oriented voters, but who are the main stakeholders in the party? Not left intellectuals, not left politicians, but Meciar’s privatizers.*’ (Meseznikov, interview). Hence, the lack of socio-economic issues as the main axis of competition among political parties produced not only the weakness of the main left party (linked with its participation in the first anti-Meciar coalition government), but it also enabled the emergence of centrist populism and the rise of new parties (Smer being the most successful, but ANO being another example of the same kind) that positioned and identified themselves as being beyond the old pro- or contra-Meciar political divide. At the same time, by getting votes simply on the basis of their being novel and beyond the old divides, the new parties were hardly pressed into actually presenting voters with substantively new programs as the logic of programmatic differentiation at the time was simply not based on left-right distinctions. The end result was that during the 2002-2006 coalition government, i.e. the one that actually established the foundations for the Slovak Competition State, a principled opposition to neoliberal policies was largely absent from the Slovak Parliament.

In addition to the weakness and divisions in the political ‘left’ in Slovakia, another consequence of the lack of socio-economic programmatic differentiation and the focus on second-order political regime issues was that the neoliberal parties gained part of their legitimacy on the basis of issues *other* than their economic program. Indeed, public opinion surveys show that in the 2002 elections the leading neoliberal party – SDKU – gained votes primarily on the basis of ’sympathy and trust’, as well as their unreserved support for NATO and the EU, while only a minority of its voters stated that the party’s program was the main reason for their electoral choice. Moreover, among all of the voters of all the parties who made it into the 2002 Parliament, SDKU voters were the least driven by programmatic concerns, and were the most driven by support for the EU and NATO – KDH voters and even Smer voters were much more influenced by parties' programs in their electoral choice (Ucen et. al., 2005). Hence, the Meciarist political legacy, and the concomitant formation of the Slovak party system around political regime issues rather than socio-economic divides, left two important implications. The first was the weakness of the left economic agenda and the lack of a viable leftist economic program that would go beyond the invocation of social concerns on top of neoliberal policies. The second consequence was the fact that neoliberal parties could obtain considerable political and electoral support despite the fairly low support amongst the population for the reforms promised and adopted by the neoliberals. Thus, the most successful party on the right-wing pole actually owed most of its votes to its strong identification with the European agenda rather than to the popular support for the neoliberal reforms the party was proposing.

The 'hole' on the left side of the Slovak political spectrum was visible in the alignment of voters as well. Namely, while PDL was primarily the party of urban and high-educated voters, after the party's dissolution, the latter population was not picked up by the newly emerging Smer. To the contrary, the socio-demographic characteristics of voters of Smer actually did not deviate from the mean population either in educational or in urban-rural dimension – in other words, Smer voters corresponded to the profile of 'a typical Slovak' (Gyarfasova and Krivy, 2007). The more educated and urban population was thus left either to vote for SDKU, which indeed increased their share of university educated voters from 24% to 34% of their electorate between 2002 and 2006, or to abstain from voting altogether – which certainly contributed to the extremely low turnout in 2006 elections. The older, less educated and predominantly rural population, on the other hand, maintained its allegiance to HZDS (Gyrfasova and Krivy, 2007) while voters with university degrees, students, entrepreneurs and traders, managers and professionals predominantly voted for SDKU. By way of contrast with this, in the Czech Republic the category of professionals (higher-educated non-manual workers as opposed to routine non-manual workers, manual workers or the self-employed) in the 2002 and 2006 elections predominantly voted for the Social Democrats (Vecernik, 2009: 151). On the other hand, in 2006 Smer largely claimed the former electorate of HZDS, namely those older and less educated voters living in rural areas. Younger supporters of HZDS however largely migrated to nationalist SNS or abstained from voting altogether (Gyrfasova and Krivy, 2007).

This realignment was also the result of an electoral campaign that clearly revolved around the continuation of neoliberal reforms (advocated by SDKU) and the criticism of the reforms espoused by Smer. However, while the politicization of neoliberal reforms in 2006 signified that Slovakia had moved away from the Meciarism vs. anti-Meciarism cleavage towards a socio-economic left-right cleavage (Hlousek and Kopecek, 2008), the difference from the Czech case is that the Slovak left agenda opposed the reforms, but did not present a real economic alternative. Thus, the minimalist Competition State established in Slovakia during the 2002-2006 neoliberal government remained in place even after neoliberal parties were replaced in power by the populist 'left'.

Framing competitiveness – liberal foundations of the Slovak Competition State

Thanks to the unchallenged hegemony of neoliberal ideas in the building of transnational capitalism, the Slovak Competition State was built on rather different ideational foundations than the Czech one. The primary inspiration was drawn from the classical liberal theories, where economic growth and competitiveness were assumed to stem primarily from individual creativity and initiative while the role of the state was reduced that of establishing an institutional framework for the functioning of market competition and nothing else. Thus, the strategy for increasing competitiveness was indeed identified with the process of 'state shrinking' and of establishing a small and non-interfering state. For instance, in their election program of 2002 the SDKU states: '*We will stand for the gradual reduction of the tax burden so that the share of government in GDP prospectively reached 30 to 35%. Maintaining such a share is one of the most effective tools in the fight against excessive statism, paternalism and bureaucracy. (…) The current Slovak economy suffers large distortions that prevent fuller development of the creative activity of the population. In order to eliminate these distortions, it is necessary to complete the reforms that lay the foundations of modern society. We want reform that will strengthen the human sense of personal responsibility for their living standards. Such reforms are a sure route to a prosperous and equitable society. People who understand their life as a creative activity, will have more wealth and the economy will create more jobs.'* (SDKU-DS, 2002: 9-10)

Consequently, the main agenda was to reduce the role of the state that of the minimalist, night-watchman state: '*Reforming the tax system and the social system will bring our economy to the path of economic freedom for the broad population of our country. Our long-term goal of fiscal policy is to reduce the overall tax burden. (…) We want the state to intervene in the economy only minimally. Its mission is to provide a framework for free competition. In this role, however, it must be consistent and firm. (…)Decreasing the extent of state intervention in the Slovak economy is considered as one of the basic prerequisites for increasing the competitiveness of the Slovak economy, and also a key tool in the fight against corruption. Therefore, we will continue to support the expansion of the operation of market principles.'* (SDKU-DS 2002: 10).

The main strategy for increasing competitiveness was thus identified with increasing 'economic freedom' or, in other words, limiting as much as possible the redistributive role of the state in the economy. Thus, while for Czech policy makers increasing competitiveness meant a more active role for the state in fostering specific kinds of investments, as well as in increasing its own investment in human capital through education and retraining of the labour force, for Slovak policy makers increasing competitiveness was entirely identified with a small state that 'distorts' the decision-making of economic subjects as little as possible. The Slovak Competition State was hence primarily a 'shrinking' state – and consequently the main goals of the broad package of reforms enacted by the 2002-2006 government were not just to reduce the budget deficit, but also to simultaneously reduce public expenditure and the proportion of GDP made up by tax revenues.

Furthermore, as the emphasis was on fostering individual creativity as a way of achieving economic growth and increasing competitiveness, reforms aimed at ensuring a low administrative burden and enhancing the ease of doing business were considered crucial not only for attracting FDI, but also for building a knowledge-based-economy. In the words of an advisor in the Office of the Plenipotentiary for Knowledge-Economy (part of the Ministry of Finance): '*Business environment is critical for building a knowledge-based economy. If you are the kind of person who is capable of inventing new procedures, new products, you are also the kind of person who is able to do the math and calculate whether it would be more profitable for you to do your business in Slovakia or in CR or some other country. If we want to attract sophisticated companies, sophisticated investors, sophisticated managers, we have to offer them an environment in which they can do business easily. Another thing is that KBE and innovation economy that is so successful in Israel, Finland, US, rests on small entrepreneurs. It rests on a person who decides that, rather than trying to find a secure job in a large bank or multinational or state sector, they will try to take an idea and turn it into profit. A person making that decision inevitably takes into account how difficult it is going to be to build a firm, how difficult it is going to be to run it and what happens if the idea fails. The more burdens you put on the entrepreneur, the more he reads in the news that it is hard to do business or that it is hard to dismantle a firm that has to go bankrupt, the more likely a person is to say: 'in the end, I am better off working for IBM than trying to struggle on my own.' So assistance with as little regulatory burden as possible is critical to help people make that decision. And especially in a country which doesn't have a great history of entrepreneurship and which has very negative view of entrepreneurs, we have to take every step possible to help people struggle on their own and try to implement their own ideas.*' (Sapak, interview).

The stark difference between the architects of the Czech and Slovak Competition States is apparent also in their perspective on the broader consequences of their policies for the terms and conditions of global competition for capital. While for the Czech Social Democrats 'competitive' tax reductions were rejected on the basis of their unfairness and their contribution to an overall 'race to the bottom' in Europe (CSSD, 2005); for Slovak neoliberals, tax competition among countries was seen as beneficial as it would lead to the widespread adoption of the best reform models. In the words of the Slovak Minister of Finance, Miklos: '*Efforts of some countries to restrict tax competition by the harmonization of tax rates should be considered harmful. Tax competition leads to higher pressure to realize inevitable changes and reforms, market flexibility, the increase of public administration effectiveness and other needed structural reforms. And here lays also the base of the problems of many Western European countries. Tax and other competition from new EU member countries only hold up a mirror of preparedness to face severe global competition.*' (Miklos, 2008: 70). Not surprisingly, Slovakia opposed any attempts at tax harmonization at the EU level. Hence, in addition to determining *domestic* policy choices, national politics also plays an important role in the attempts to limit the 'race to the bottom' at the supranational level.

The socio-economic models seen by key policy makers as desirable role-models also sharply differed. While for the Czech Social Democrats, Sweden was usually taken as an example of an economically and socially successful model, the Slovak neoliberals proudly stated that Slovakia is the only of the Visegrad countries to have successfully achieved the transition from a continental European to an Anglo-Saxon liberal model – and that it was precisely this turn that saw it join the fastest growing European economies such as the Baltic republics and Ireland (Miklos, 2008). Thus, while Ireland indeed provided inspiration for both the Czech and the Slovak Competition States, given the differences in the political ideologies of the key policy makers and architects of these states, different aspects of Irish miracle were copied – the Czechs focused more on copying the Irish earlier generous investment incentives and strong and independent Investment Promotion Agency, while the Slovaks focused more on the liberal labour market, small state and low tax parts of the Irish model.

Increasing competitiveness was thus associated primarily with establishing a 'modern' tax system and a 'modern' welfare state, with modernity entirely defined along the lines of marketization. The main ideological proponents of this idea were primarily the neo-classical, US-trained economists who, having worked in think-tanks and NGOs, joined the government as ministers or advisors after the 2002 elections. The reforms were thus designed by a relatively small group of people around Finance Minister Miklos – 'few wise men', as the executive director of the business association Business Alliance of Slovakia refers to them (Kicina, interview). Miklos himself came from MESA 10, a neoliberal think-tank that played a prominent role in the opposition during Meciar's time, while the other experts came from think-tanks such as the Hayek Foundation or INEKO. Within the Ministry, Miklos surrounded himself with a small group of hand-picked advisors that constituted the small, but very clearly neoliberal, technocratic motor of the reforms and typically came from the liberally oriented think-tanks and NGOs.

MESA 10 was particularly influential in the actual drafting of policy proposals, with 10 former or current employees of MESA 10 working on reforms in areas such as taxation (Mikloš), public administration (Viktor Nižnansky) and health care (Peter Pažitny). On the other hand, pension reforms were guided by Jan Oravec, who had worked on pension reform plans for several years at the Hayek Foundation, which he founded in 1991, while in the Ministry of Labour and Social Affairs there was an influential state secretary in charge of drafting the 2003 Labour Code by the name of Miroslav Beblavy. He was an economist and economic commentator trained in the United States and United Kingdom who had been associated with the Institute for Economic and Social Reforms (INEKO) between 1999 and 2002. Similarly, the Minister of Health from 2002 to 2006 was Rudolf Zajac, a former CEO of a pharmaceutical company who had previously written on reforms in the sector together with Pažitny from MESA 10 – and whose analysis were published by MESA 10 and IVO (Fisher et. al, 2007). Policy proposals were thus typically developed even before the right-wing parties received their clear mandate with think-tanks functioning as the generator of ideas which were simply put into practice when the political opportunity presented itself. The origin of these think-tanks stems still from the Mečiar era when they were primarily funded by US backers and liberal foundations that supported them in their fight against Mečiar. After his fall, many of the NGO representatives went to the right-wing government.

The epistemic community sketched here – constituted of ministry officials, experts, NGOs, journalists and economists from the financial sector – was able to design and implement reforms rather freely, thanks to the fact that the 2002-2006 government was marked by a strong ideological coherence and that there was simply no alternative economic program that would challenge the main assumptions of models developed by the neoliberals. While neoliberal think-tanks and NGOs were fairly active in the Czech Republic as well, and were also closely linked with the parties of the political right, they still had to compete with the economic ideas and the program developed by trade unions and the Social Democratic party. Furthermore, even the right wing parties differed among themselves on some key reform issues. No such competition existed in Slovakia and the complete hegemony of the neoliberal or 'minimalist state' competitiveness agenda resulted in a profoundly liberal set of policies that had little in common with the Czech social democratic competitiveness strategy: flat-tax, radical pension and health-care privatization, slashing unemployment benefits, and radical liberalization of Labour law. Furthermore, despite proclaiming their ambition to build a knowledge-based-economy, and in contrast with the Czech Republic, Slovakia actually decreased its spending on education as a share of GDP. The so called Minerva strategy for building the knowledge based economy was adopted only at the end of the neoliberal government's mandate, while their priority was clearly to implement the 'tough but necessary' reforms first: the privatization of pensions and health care along with labour law liberalizations and cuts to unemployment benefits. This agenda was thus profoundly different from that of the Czech Social Democrats, but it is important to note that this was not simply the result of the incumbency of the right-wing parties, but also the result of the lack of a meaningful alternative economic program. In other words, contrary to the simple partisan approach to state strategies in a global economy that would attribute particular strategies according to the colouring of the governing party (Boix, 1998; Garrett, 1998), a plausible counterfactual for such an explanation would be that, if Slovakia had have been governed by Social Democrats, its form of Competition State would be the same as the Czech one. The problem with this counterfactual however is that, at the time, there was simply no Social Democratic party in Slovakia and there was no alternative economic program on offer, especially not one based economic growth on some other strategy of managing the country's insertion in transnational markets. Hence, neoliberal program turned out to be the only one that promised to bring Slovakia closer to the West, to 'modernize' its fiscal and social security system and to transform it into a 'market economy' while also attracting foreign investment and increasing competitiveness. As a result, competitiveness in the Slovakian context was understood rather differently that in the case of the Czech Republic – so the set of policies established during the period of economic transnationalisation decisively set Slovakia on the low-road Competition State path.

Economic reforms of the first Dzurinda government – return to the West

The first Dzurinda government inherited a macroeconomy profoundly out of balance. The current account deficit had been on the increase since 1996, ranging between 9 and 10% of GDP, and it was to a large extent financed by foreign borrowing, rather than foreign investment. This unsustainable development exerted pressure on the national currency and resulted in the weakening of the exchange rate of the domestic currency, i.e. a *de facto* devaluation, in October 1998. The economy was also burdened by a credit crunch which saw a tightening of external financing to Slovakian enterprises, thus contributing to a total indebtedness level of 58 % of GDP (Mathernova and Rencko, 2006). There was compounded by a large share of non-performing loans on the balance sheets of a banking sector that was on the verge of insolvency, so the government had to cover the costs of transforming it too (Fisher et. al, 2007).

Furthermore, the combination of Meciar's expansionary fiscal policy and the restrictive macroeconomic policy of the National Bank caused interest rates to rise sharply, peaking at 20% for new loans in February 1998, again contributing to the insolvency rate in the corporate sector (Mathernova and Rencko, 2006).

After the switch to a floating exchange rate, the cabinet had to pass economic reforms to restore macroeconomic stability, which they succeeded in doing in 1999. The benefits, however, were not immediately visible since GDP growth declined in the course of 1999 and unemployment rose from 12.5 to 16.2% (Henderson, 2002). At the same time, inflation also peaked at 16.6% in March of 2002; primarily because of the liberalization of some key price-regulated sectors – electricity, gas, transport, heating and rents. After that, however, inflation rates gradually decreased. Meanwhile, the current account deficit again reached 9.2% of GDP in 2001. That said, the new deficit was different in structure compared to previous years because it consisted primarily of imports connected with the recovery of investments, rather than household consumption and it was also almost entirely accounted for by foreign investment, rather than foreign borrowing. By 2000 there were signs of progress being made in reversing the previous situation of low FDI in Slovakia – by that point, FDI flows per capita were the 2nd highest in Eastern Europe.

In terms of economic policies, the first Dzurinda government brought about a clear break with the Meciar period. Instead of building national capitalism, blocking the privatization of 'strategic' sectors and remaining indifferent or even hostile towards foreign investment, the coalition government embarked on a strategy of actively supporting foreign investment in Slovakia and promoting Slovakia as a brand to foreign investors. The most important reforms during the 1998-2002 government were, however, focused primarily on macroeconomic stabilization, the restructuring and privatization of the banking and enterprise sectors, the regulation of financial institutions and natural monopolies, alongside some key legal and institutional changes related to bankruptcy, access to credit and corporate governance.

Initially, the coalition partners disagreed on all of the aspects of the first austerity package, with particular opposition coming from SDL that held several key economic portfolios in the new government – notably, the ministries of finance and labour, as well as agriculture. The first austerity package did not bring desirable results and, in May 1999, Slovakia was again on the brink of financial and fiscal crisis, with renewed downward pressure on the koruna and the ensuing panic in the market. This time around, however, a consensus was achieved among the coalition partners, with Dzurinda, Miklos and Schmognerova announcing the package of reforms at a joint press conference in May 1999, thus demonstrating the consensus and the commitment to reforms on the part of government. The package included price deregulations, an increase in VAT rates and the imposition of import surcharges (The Slovak Spectator, 1999).

Agreement was also reached on the reform of the financial sector. At the end of 1998, approximately 35% of loans were non-performing and the government decided to restructure and then privatize the banks, with the technical and financial help of the World Bank. The banks were restructured, with bad loans transferred to the Konsolidacna Banka created especially for this purpose and then sold, primarily to foreign investors, resulting in a large share of bank assets being in foreign hands during the 2000s. Furthermore, new bankruptcy legislation took effect in July 2000 that strengthened creditors' rights and allowed companies to continue operating after filing for bankruptcy; while the 2001 commercial act strengthened the protection of minority shareholders (Mathernova and Rencko, 2006).

All of the above were seen as necessary preconditions for achieving Slovakia's integration into Western associations, such as the EU and the OECD – indeed in its reports the EU explicitly mentioned the need to abolish the Revitalization Law and pass bankruptcy regulation. Since integration with the West was the most important glue holding the coalition partners together (and constituted an important aspect of their opposition to Meciar), these reforms were relatively easily agreed upon. The agreement was further facilitated by the government's intense engagement with advisors from the OECD, EU, IMF and World Bank, which provided a policy blueprint leaving only limited space for disagreement among coalition partners. Despite the fact that Slovakia was not dependent on the loans of either the IMF or the World Bank, and could easily borrow on international markets, especially after 1999 with the implementation of the reforms welcomed by the markets, the technical advice from these institutions was still highly appreciated and helped the government create an image of the reforms being truly necessary on the domestic political scene. Nevertheless, it is important to note that the technical advice of IFIs was demand, rather than supply driven and was actively sought by the local neoliberals, instead of being authoritatively imposed from above (Mathernova and Rencko, 2006).

The above reforms merely constituted the first steps towards establishing a functioning market economy, but still no specific direction or strategy for managing the insertion into global markets was yet being developed. Such a strategy would have to encompass policies that were still a matter of disagreement among the coalition partners (corporate taxes being an example), so it would have to wait for the next entirely right-wing government. Thus, the first post-Meciar government certainly turned towards actively attracting FDI, but it actually adopted a less clear agenda as to how this should be achieved than was the case with the parallel government in the Czech Republic. Initially, the government actually started to play on both fronts – decreasing corporate tax rates as well as rolling out investment incentives. Still, both of these met obstacles: while radical tax cuts were opposed by the SDL Finance Minister Schmognerova who was worried about the state of public finances, a strong and independent incentives policy based on Investment Promotion Agency was not possible due to the institutional conflict between the Slovak investment promotion agency and the Ministry of Economy, not to mention the fact that an activist industrial policy for fostering FDI was not really on the agenda of *any* of the political parties. The result was that it was only after the 2002 elections and the establishment of the second Dzurinda government – this time completely right-wing and without the Social Democrats– that Slovakia decisively turned towards the low-road Competition State model.

Bribing the investors – the politics of investment incentives in Slovakia

The first steps towards attracting FDI were made already in 1998 when the new government announced the simplification of import procedures, strongly criticized by investors and commentators. In 1999, the government adopted the Strategy of Support to FDI Inflow as well as an amendment to the Income Tax Act which granted 5 year tax holidays to foreign companies if they invest 5 million Euro in Slovakia, with an additional 5 years if they invest another 5 million Euro in that same first 5 years. This actually made the Slovak scheme comparable to the Czech one, in that it also foresaw 10 year tax holidays for companies that invested at least USD 10 million. Another condition was that they export at least 60% of their production (CEPA, 2000: 14) and thereby help reduce the high current account deficit. Furthermore, the government also reduced the corporate tax rate from 40% to 29% in November, with further cuts introduced in 2001 when corporate tax reached 25%, while personal income tax was decreased from 42% to 38% (The Slovak Spectator, 2001a).

Partly associated with the establishment of the new government and their parallel tax reductions and investment incentives, FDI in manufacturing started to pour into Slovakia in the form of numberous greenfield investment projects, as well as the expansion of existing production facilities. One of the most important projects of this era was Volkswagen's expansion of its production plant in Bratislava, a move that was heavily subsidized by the government through the creation of an industrial park for the suppliers, tax holidays, and infrastructure such as flats for the employees, rail and highway connections directly to Volkswagen's gate, and the adjustment of school curricula (CEPA, 2000). Furthermore, in 2001, the government passed another law on tax holidays which extended them to ten years for big investors and investors in regions with high unemployment; and in doing so it explicitly referred to the practice of other Visegrad states as putting pressure on Slovakia to introduce further generous tax breaks (The Slovak Spectator, 2001b). The Law on Investment Incentives however did not lay down detailed conditions for obtaining incentives, only setting out a very broad framework and leaving a lot of space for tailored deals to be negotiated between the government and specific investors.

The new orientation towards actively enticing FDI in this period was clearly signalled by the establishment of the new Investment Promotion Agency – SARIO – in 2001. SARIO's predecessor, SNAZIR, had been established during the Czechoslovak Federation and was not very effective in attracting FDI; it had a deservedly bad reputation among investors and was also involved in scandals associated with the management of PHARE funds (Trnik, 2007). The establishment of a new body was thus meant to send a clear message to investors that the new government indeed *is* fully committed to attracting FDI. Similar to the CzechInvest, SARIO was also founded with money from the PHARE project and it also recruited Irish consultants to work on its establishment, with Irish IDA again serving as the role model (Kučera, interview). However, compared to CzechInvest, SARIO showed important institutional and operational shortcomings and it never became the institutional anchor of the Slovak strategy for attracting FDI. Its ownership was spread over 6 Ministries, its scope of responsibilities was not clearly separated from the Ministry of Economy and it was also the least well-staffed investment promotion agency among the Visegrad countries, with half the financial resources that CzechInvest had and even less than its counterparts in Hungary and Poland. Consequently, the agency was actually considered to be simply an appendage of the Ministry of Economy, with investors quickly learning that the Ministry might be better able to solve their problems. Instead of acting as a one-stop-shop, SARIO turned out to be one-more-stop-shop (Trnik, 2007). Furthermore, from the very beginning, the leadership of SARIO was subject to political horse-trading, resulting in a very high staff turnover, especially for high-level positions such as the CEO who was always directly appointed by the Minister of Economy, with no checks and balances on Minister's decision. '*Sario was always understood as some kind of political trafika – a body where you put people that you needed to reward for something. It was not a working body – every time the government changed leadership in SARIO was changed. Sario was under greater political influence than CzechInvest. CzechInvest was in many respects insulated from political influences. (…) SARIO had 14 CEOs in a very short period of time when CzechInvest had maybe 2 or 3, all of them really specialists and not party members.* (Trnik, interview)

The lack of any clear institutional anchor for investment promotion hindered not just the attraction of investment itself, but also the distinct logic of investment incentives as *the* tool for

FDI attraction. Both SARIO and CzechInvest were keenly interested in the government's commitment to investment incentives – however, since the management of SARIO was frequently changed, it never had such strong leverage and influence in the government decision-making as the management of CzechInvest had at the time.
On the one hand, this politicization of SARIO and its much weaker position in the institutional configuration of the Slovak Competition State suggests that it might have been the low level of state capacity (in Peter Evans' terms) that explains the development of a high-road Competition State in the Czech Republic as opposed to the low-road one in Slovakia. Nevertheless, the apolitical view on state capacity is not justified here since the institutional independence of CzechInvest appeared primarily due to the strong political and programmatic backing it received from CSSD, while it was seriously undermined under the government of neoliberal ODS. In other words, the relative independence and 'embedded autonomy' of key state agencies dealing with development in transnational capitalism is itself the result of the existence of a political program that would base the development on the operation of such an agency. This political program, as already argued, was present in the Czech Republic, but *not* in Slovakia. Furthermore, while the leadership of SARIO in Slovakia was indeed subject to political negotiations rather than being left to the non-party experts, some other positions, such as the advisors or heads of department in the Ministry of Finance, were clearly staffed with independent economists with backgrounds in think-tanks and Western academia rather than being used as political *trafika*. Hence, the politicization of state institutions in Slovakia was only partial – and the question of which institutions do indeed become politicized, and thus which ones are considered to be important enough to be given substantive independence in policy development and implementation, is itself dependent on the political program and the understanding of which policies – and consequently which institutions – should be the main drivers of economic development.

Throughout the period from 2002 to 2006, the Dzurinda government continued to grant investment incentives and to actively lure investors to Slovakia as an investment site. However, unlike their Czech counterparts, the Slovak FDI-oriented political parties never took pride in giving out investment incentives and never made it the flagship of their political program. To the contrary '*It was one of the most hidden secrets. The government really tried to hide from the public what kind of incentives they offered to companies.*' (Malova, interview). As a result, some of the most generous deals actually caused public outcry and reactions in the media condemning the generosity or the secrecy of the deals. As opposed to the Czech Republic, where investment incentives were a clear governmental policy with CzechInvest given a free hand to negotiate deals and the final decision on granting the incentives resting with the Ministry of Industry and Trade, incentives in Slovakia had to be agreed upon by the whole government, thus leading to situations whereby disputes among coalition partners could come to bear in the decision on a specific investment deal. This became the case especially since 2002 when the Ministry of Economy came under the control of Pavol Rusko, the leader of right liberal coalition party, The Alliance of New Citizen (ANO), and the director of the major private TV station Markiza. Often likened to a Slovakian Berlusconi, Rusko often used the issue of investment attraction as an instrument of his own personal promotion. As a project manager in SARIO at the time recalls: *'When SARIO was founded in 2001 no one had clear idea how to do investment promotion. However, when Rusko was Minister, he saw SARIO as support in efforts at marketing Slovakia as well as marketing his own achievement. Basically, SARIO was considered as a personal PR agency for the Minister.'* (Kučera, interview). The first deal he successfully concluded was with Peugeot PSA, where Slovakia successfully outbid Poland and the Czech Republic to secure the investment, largely praised as 'the investment of the decade' by Rusko and 'another Slovak lokomotive' by Dzurinda (Kolesar, 2006). However, another big deal concluded by Rusko turned out to be more politically sensitive. It referred to the opening of Hyundai Kia in Zilina where Slovakia rolled out probably the most generous investment support seen so far – subsidizing 15% of the investment, but also offering to build a luxury village for managers, providing English language education for their children, hospital and airport facilities, the support of the Technical University in Zilina and so on. Initially Kia actually withdrew from the negotiations with Slovakia, which led Rusko to fire the head of SARIO and fly to South Korea to meet the management himself. After a long presentation which the Minister ended by stating that even the name of Slovakia ends with Kia, he persuaded the management to reconsider their decision and in the end Slovakia was indeed chosen as the investment site. The agreement was, however, heavily criticized since Kia had almost no obligations towards the government, or in terms of actually carrying out the planned investment (Kolesar, 2006). The criticism of this excessive deal started to spark public concern with the generosity of investment incentives, with the MPs from the main opposition party Smer asking the government to make all contracts with investors public. This made the subsequent deals much more difficult and actually saw many fail, notably the proposed investment by Hankook Tires where Rusko again made promises to the investor, but the deal was eventually rejected by the coalition government with the subsequent Economy Minister, Jirko Malcharek, stating that Slovakia is 'not in a position to buy investors' (The Slovak Spectator, 2005). The failure of the Hankook Tire investment project (eventually won by Hungary), as well as the subsequent government decisions, can thus be interpreted as some of the results of the political dissatisfaction with previous generous investment deals, with Kia Zilina being the most publicly criticised one.

Investment incentives also encountered political opposition from domestic entrepreneurs, who complained that the government was discriminating against domestic investors in favour of foreigners. After the 2001 Law on Investment Incentives was passed, a group of big domestic industrialists established an association, Klub 500 (named after the fact that all of them had more than 500 employees), in order to collectively oppose the government's FDI-oriented policy and lobby for the abolishment of incentives. Other business associations also opposed it – in particular, Business Alliance Slovakia (PAS), as well as RUZ (Republikova Unia Zamestnatelov) and AZZZ, although among the latter associations one can find members who had themselves benefited from incentives. Although the members of Klub 500 were not exactly a main partner of the right-wing government, as many of them were involved in Mečiar's privatizations and are usually seen as being closer to Smer, their opposition nevertheless created obstacles for the government since neoliberal leaders had no clear ideational platform for justifying these incentives. Unlike Czech Social Democrats, who made a point of having investment support as part of their electoral program by depicting it as a means of increasing competitiveness, for political parties whose primary program was a small state and zero-interference in the economy, investment incentives indeed could appear as simple 'bribes' to foreign investors.

As a response to the public demands, voiced both by the media and business associations, as well as the opposition parties in Parliament, in 2005 the government issued a table that clearly spelled out the incentives that were available for investment in high value-added enterprises and in areas of high unemployment. The new and more transparent criteria thus reduced the discretion of ministries and bureaucracies in dealing with investors, and were presented in particular as the response to lucrative deals struck by the former Minister of Economy (Fisher et. al, 2007). However, Slovak business still considered incentives to be discriminatory: '*We communicated with government pointing out that this law is discriminating against domestic investors, we tried to persuade them to change the law. Our government changed the law on paper, but in practice we realized that the system stayed the same. When a foreign investor came to Slovakia he received enormous money, tax holidays and so on, while domestic ones, well, we are here, we are not going anywhere, so we do not get them typically.*' (Gregor, interview).

Why was the right-wing government reluctant to give more investment incentives? The main reason, as already stated, was simply that investment incentives were not part of the government's core policy – they were indeed perceived as a necessary evil and it was only justifiable to use them to the extent that they would bring not just visible economic benefits to the country, but also visible political points to the incumbents who bring the jobs to the country. As the primary target of investment attraction was manufacturing FDI (due to the manufacturing profile of the workforce), incentives were indeed part of the game as in many sectors investment simply cannot be attracted *without* incentives (Thomas, 2010). However, the neoliberal government was clearly not willing to go beyond securing several big investment projects, and instead relied on the broader package of reforms designed to make Slovakia a better – i.e. cheaper – business environment. Thus, the relative generosity of *individual* investment deals in Slovakia was down to a desire to attract some landmark investments combined with the relative inexperience of the Slovak government in negotiating with multinationals. It did not, however, translate into high levels of state aid *overall* as it was not part of a consistent and programmatically based strategy that would see the role of investment promotion given to a single agency backed with substantial budgetary resources. Rather than relying on investment incentives as a form of 'activist industrial policy', the Slovak government turned more to implementing radical fiscal and welfare state reforms as the main instruments for creating a 'better business environment' and increasing competitiveness.

The birth of the 'Tatra tiger' – flat-tax as the brand of the Slovak Competition State

As opposed to investment incentives, tax reforms took centre stage in the outlook of the 'reform government', and were widely perceived to be the policy that made the Slovakian 'Tatra tiger' possible. The package of reforms put forward by the Finance Minister Miklos in 2003 focused on reducing the deficit in public finances below 3% of GDP, simplifying the taxation system and reducing tax evasion. While stating that the reforms should raise competitiveness and promote investment, the emphasis was now on creating a favourable investment climate overall rather than on offering generous investment subsidies which were not considered in line with the EU state aid policy (Fisher et. al, 2007). The fact that certain forms of subsidies (notably, those for horizontal objectives) were still legal under the EU state aid rules did not play a role as there was simply no political will to continue competing with the other Visegrad states in rolling out ever more generous investment support schemes.

The main elements of the fiscal reform included: a unified rate of VAT at 19%, thereby abolishing the previous two-tiered system with reduced rate for food and medicine; an increase in excise duties on cigarettes, fuel and tobacco in line with the EU standards; a flat corporate income tax at 19%; a flat personal income tax at 19%, undoing the previous progressive taxation regime; and the abolishment of the dividend tax, the real estate transfer tax, the gift tax and the inheritance tax. Furthermore, the portion of citizens' income that was untaxed was increased, which meant that poorer Slovaks were exempt from paying income taxes altogether – but which also meant that low-wage work was actually fostered and subsidized by the government. The Parliament approved the reform package in late 2003 and the reforms became effective in January 2004. By adopting flat-tax Slovakia thus joined the group of more neoliberal reformers in the East, such as Estonia, Latvia or Lithuania which introduced flat-tax already in the late 1990s. By that time, the idea of flat-tax had been widely circulated in liberal policy communities and it was particularly praised by the Heritage Foundation as neutral, efficient, good for competitiveness, fostering work motivation and increasing liberty (Mitchell, 1996). Mitchell himself presented the panacea of flat-tax at a conference organized by INEKO in Bratislava in March 2004 – and similar ideas were echoed by Slovak neoliberals, in particular Ivan Miklos who praised Slovak fiscal reforms as bringing about a 'light, non-distortive, simple and transparent tax system that will create business and investment friendly environment for both individuals and companies' (Miklos, 2004: 3). While flat-tax had thus already been adopted by other countries, the distinctive feature of Slovak model was the elimination of almost all exceptions, special rates, all deductible items – or in short, the '*elimination of deforming components in tax policy which were used for other than fiscal objectives'* (Miklos, 2008: 63). Another important aspect of tax reform was the elimination of 'double taxation' wherever possible – including the rolling back of the dividend tax, inheritance tax, gift tax and real estate transfer tax. Among both policy makers and businessmen this aspect was widely perceived as positive and, together with allowing 100% repatriation of profits, it was seen as an important part of improving the business environment and competitiveness of Slovakia. This again puts the Slovak understanding of competitiveness and an easy business environment in stark contrast with that of the Czechs – the Czech social democrats' argument would be precisely that low taxes per se do *not* foster investment since they do not differentiate between reinvestment, paying dividends to shareholders or 'buying luxury cars' (Havelka, interview).

The tax reform was thus designed with the aim of fulfilling the principles of '*justice, neutrality, simplicity, exactness, effectiveness and elimination of double taxation – principles that are highlighted in almost every tax theory textbook, but hardly any country adhere to these principles in its tax system*' (Miklos, 2008: 63). Furthermore, it was precisely this textbook neoliberalism, along with the low level of taxation, that was seen as the best recipe '*to transform the Slovak tax system into one of the most competitive systems in EU and OECD*' (Miklos, 2008: 64).

'*Government assumed that the tax reform would contribute to improvement of business environment, increase of motivation to work, start business activities and invest, increase of foreign investments and decrease of tax evasions.*

Today, after more than three years from new tax system implementation, we can state that these assumptions were fulfilled and in some areas the development even exceeded expectations. Tax reform became an important marketing asset of Slovakia and played an important role in attracting foreign investors. It is connected not only its simplicity and low level of taxation but also with the fact that overall taxation of capital in Slovakia is the lowest among all EU countries due to elimination of dividend tax.' (Miklos, 2008: 65).

The advertising of flat-tax as one of the key measures improving Slovakia's competitiveness indeed resulted in the widespread belief among experts, policy makers and businessmen alike that it actually played an important marketing role in promoting Slovakia to foreign investors. Even for those who acknowledge the importance of other factors for manufacturing FDI, especially the availability of local suppliers, cheap labour force, or investment incentives, flat-tax is still an important part of the story: '*Flat-tax made Slovakia known as a business-friendly country. (…)Flat-tax put Slovakia on the map of investors' potential locations while in the end it always came to the proximity of suppliers and the incentives the government was able to provide. If you divide the factors into those that make the difference in the first and second phase of decision making, this is what you get.'* (Kucera, interview).

A similar attitude is held by the biggest Slovak employers' association, AZZZ, which also saw tax reform as the main driver of FDI. '*First of all, fiscal reform was the main reason for the rise in FDI. In 2006, after introducing the tax reform, there was the highest FDI inflow in Slovakia. Investors especially welcomed the lower corporate income tax and the abolished tax on dividends'* (AZZZ, interview)

Flat-tax also tops the list of reforms praised by the Business Alliance of Slovakia, the local referee for the World Economic Forum Global Competitiveness Report, as the combination of tax and labour law reforms saw Slovakia receive very high rankings in the Global Competitiveness Index in 2004 (Kicina, interview) - all of this despite the fact that flat-tax does not have a particularly clear effect on FDI attraction. Those companies which came to Slovakia were certainly not satisfied purely with the 'business friendly environment', but they still demanded incentives packages. Furthermore, as we can see from the Slovakia's neighbours, FDI was flowing into the region in this period – and it was even going to countries that never introduced this type of reform.

Other reforms highly appreciated in the Slovak and international policy communities include the pension and labour reforms as well as the broad welfare state overhaul. I turn to these in the following section.

Minimizing the welfare state

Another important set of reforms that was certainly designed to make Slovakia more business friendly was the welfare state retrenchment. However, similar to in the fiscal policy, radical interventions in the welfare state had to wait for the right-wing coalition government due to the sharp disagreements among the1998-2002 coalition partners. More radical reforms were, at that time, blocked by the Party of Democratic Left which held the post of the Minister of Labour and Social Affairs, so the more neoliberal part of the government – such as the Deputy Prime Minister for Economy, Mikloš – contented themselves with designing policies to implement if they ever gained more political power (Fisher, et. al., 2007). It was during the mandate of this government that a neoliberal epistemic community in Slovakia became particularly active and developed their own set of policy proposals – however these proposals would only be put into practice by the next government.

The first coalition government thus only began to develop proposals for reforming the pension system along the lines of the World Bank's preferred three-pillar system with a compulsory private pillar. As early as 1998, Deputy Prime Minister Miklos wanted to push ahead with a fundamental pension reform, featuring a capitalization pillar, in the government policy statement – however the SDL Labour Minister at the time, Peter Magvaši, opposed it and instead proposed a reform similar to the so called Canadian system where a public fund collects contributions and invests on financial markets. At the time – February 2000 - most of the MPs actually agreed with this proposal and none of them voted against it. Yet, only two years later many of the MPs had changed their minds and voted for the mandatory private pillar. (Lesay, 2009).

The first coalition government's package of social reforms thus contained a compromise between more neoliberal or 'reform minded' members of the cabinet: there were typically proposals by the Deputy Prime Minister for Economy Mikloš and his team of economic advisors, on the one hand, which were countered by ideas from the PDL and the Ministry of Labour and Social Affairs, on the other. More left wing policies included increasing wage tariffs for public sector workers in 2002, the adoption of a Labour Code in 2001 which provided for less flexibility and strengthened the position of trade unions, the introduction of universal child allowances in 2002, and repeated increases to the minimum wage levels. In this respect, the policies of the Slovak coalition government actually resembled the policies of the Czech Social Democratic government. On the other hand, some more neoliberal policies were also put in place – these included the phasing out of early retirements in 2001, decreases in the levels of social assistance benefits, as well as an amendment of the above-mentioned Labour Code in

2002 primarily regarding the provisions on working time flexibility. In particular, the cuts in social assistance benefits were designed with the aim of 'making work pay' - in 2001, some 50% of the recipients (i.e. those falling below the minimum subsistence level) were found to be in that state because of 'subjective' reasons, such as being recent school graduates, not cooperating with local labour offices or not participating in public works – and the level of benefits for these 'undeserving poor' was halved. At the same time, workfarist logic was put into practice by increasing the financing of welfare-to-work programmes, seen as the best way to temporarily halt unemployment until the economy picks up. Similar to their Czech counterparts, Slovak politicians also expressed concerns with the abuse of social benefits and the problem of insufficient motivations to work. In the words of Ivan Miklos: '*I am convinced that one of the reasons why Bratislava has the lowest unemployment rate, apart from the fact that it has the most employment opportunities, is that living expenses are dramatically higher than in the countryside. Meanwhile, welfare and unemployment benefits are the same wherever you live, meaning that in villages you can live relatively easily on state handouts, but in Bratislava it's impossible. Making social benefits rules more strict, therefore, would be an effective way of lowering unemployment and creating better conditions on the Slovak job market.*' (The Slovak Spectator, 1999b)

Still, the reforms were much less radical and indeed included policies that actually resembled the Czech high-road workfare state policies – increasing the minimum wage, for example – while giving it a more neoliberal twist at the same time by halving the social assistance benefits. The fact that part of the governing coalition was PDL, which was closely allied with the trade unions, meant that the unions indeed saw quite some increase in their power. For instance, in 2000 a new General Agreement was signed for the first time since 1997 when, due to a disagreement on the minimum wage, social dialogue broke down. Thanks to the fact that SDL was in the governing coalition, the first Dzurinda government was '*like a honeymoon for trade unions*' (Malova, interview). Their favourable position was also apparent in 2001, when the Minister of Labour, together with trade unions, managed to pass the new Labour Code that raised the cost of labour, severely restricted labour mobility and gave broad powers to trade unions regarding the firing of workers. Although some of the most restrictive initial provisions were removed from the bill, the code still created a less flexible labour market (Fisher et. al, 2007). Thus, this development was again different from the simultaneous Czech changes: there the government of the Social Democrats actually introduced a Labour Law that increased the flexibility of the labour market, in particular through creating legal conditions for more flexible working time schedules and part-time contracts (Keune, 2006).

Therefore, the overall picture of welfare state developments during the first Dzurinda government is one of minor reforms governed by disparate and sometimes conflicting political logics. Although the government had by then already turned towards attracting FDI, social policy was still not considered part of this broad reorientation, nor was it seen as one of the tools to make the country more attractive to investors. At the same time, however, the government did not subscribe entirely to a generous workfare state program along the lines of the Czech Social Democrats' initiatives – expenditure on education, for instance, decreased during the coalition government compared to the Czech outlay which rose as a share of GDP in the same period. Thus, even in this period it is apparent that the opposition to the more liberal proposals did not really entail a fully developed alternative program; rather it was more about slowing down the pace of reform or adopting a more gradual approach that was still going basically in the same direction.

The situation however changed with the right-wing government coming to power in 2002. The post of Minister of Labour, Social Affairs and Family was taken by Ludovit Kanik, a close friend of Mikloš that shared his basic neoliberal worldview, while the state secretary in charge of the new Labour Code was another economist with links to the neoliberal circles – Miroslav Beblavy. Unlike the Czech Republic, where the post of Minister of Labour was for years reserved for welfare state experts social democratic inclinations , in Slovakia it was neoliberal economists who were to head social reforms. The first target of the social reforms was the 2001 Labour Code, the object of severe criticism from employers' associations and chambers of commerce. The new legislation increased the flexibility of the labour market and created incentives to entice unemployed persons back to work faster, particularly through introducing an obligation to report to the local labour office every fortnight. The measures gained huge support from domestic and foreign investors as well as neoliberal commentators, and contributed to the World Bank's assessment of Slovakia as a top reformer of 2004. Furthermore, the government abolished the Tripartite Act in autumn 2004, depriving the trade unions and employers' organizations of their privileged role in policy making, and replacing it with a mere advisory function (Fisher et. al, 2007). The reforms also included increased spending on active labour market policy – however, this consisted primarily of projects financed by the European Social Fund, as well as employment subsidies to foreign investors, whereas the national resources spent on active labour market policies in fact declined between 2004 and 2006 (Beblavy, 2008). The main emphasis was actually put on radically cutting unemployment benefits, thus corresponding to the 'minimalist' workfare state paradigm. In addition, the reform brought about a merger between the old National Employment Bureau, which had been governed on a tripartite basis, and the state-run welfare offices in order to create a new Central Office of Labour, Social Affairs and Families – simultaneously abolishing the representation of employers and trade unions on the board of the institution (Beblavy, 2008).

The pension system was also reformed along the lines of a three-pillar mechanism with a mandatory private pillar, established in January 2004. The Law on social insurance of 2003 replaced the old law from 1988, and served to push back the retirement age but it also changed the pension benefit formula into a PAYG system by abolishing the notion of intra-generational redistribution and making the level of pension benefits dependent strictly on working period, on individual wage, on the performance of the Slovak economy and on whether one retires before or after the retirement age. Hence, there is no minimal pension benefit – the level of benefits depends solely on the above criteria. Those whose pension benefits do not meet the minimum living standard will receive additional benefits from the social assistance system. The Slovak PAYG system thus completely abolished the previous intra-generational redistribution paradigm and shifted entirely from a risk-pooling to a self-insurance principle – which in itself makes it rather exceptional in Europe (Lesay, 2009)

However, the most important part of the pension reform was a law in 2004 which established the mandatory private pillar, formed by redirecting half of the pension contributions away from the state Social Insurance Agency and into private pension funds. Under the new system, the rate of contributions to Social Insurance Agency is 28.75% of the gross wage, with 18% being old-age insurance. For employees who joined the second pillar, 9% of their gross wage is allocated to personal accounts in private pension funds, and 9 % to the pay-as-you-go system. The reform saw an individual's assets in private pension accounts become tax-exempt and also made them inheritable (Lesay, 2009). The reforms thus transferred greater responsibility for retirement savings and pension-fund investment choices onto the individual, while at the same time stimulating the Slovakian capital market.

The reforms were initiated by the Ministry of Labour, more precisely by a team assembled by Minister Kanik and his advisor, Ivan Švejna, who in turn was in close contact with Jose Pinera, the author the Chilean pension reform. Only then was the approval of the World Bank sought, with the World Bank agreeing to the reform and indeed financing the 'special coordination unit' at the Ministry, which included well known international experts experienced in pension privatization elsewhere (Lesay, 2009; Tomes, interview). Hence, the reform was largely driven by domestic actors who were keen on implementing market-based solutions in all spheres of the social system. The 9% level of contributions to the private pillar finally decided upon was actually higher than even the reform architects expected, as their idea had been to propose 9% and then lower it in the course of negotiations with the opponents of the reform. However, since there was no great opposition to the proposal, the 9% mandatory contributions became law, making Slovakia one of the countries with the highest share of mandatory private to public contributions.

Furthermore, the government decided to undertake the reform without having a clear idea as to how to cover the transaction costs, with the expenses estimated at 500 – 1,000 billion Slovak crowns. In the end, the government decided to use the revenues from the privatization of a gas company as well as the sales of state's shares in Slovak Electrics and other enterprises, primarily in the energy and telecommunications sectors. However, the total revenue from these privatizations could amount to approximately 150 billion SKK – not even half of the estimated costs (Lesay, 2006). As opposed to their Czech counterparts, for whom the costs of the reform and the danger of budget deficit were one of the main concerns in debating the reform, Slovak policy makers turned out to be much less cautious, despite their goal of reducing the budget deficit below 3% in order to meet the Maastricht criteria for joining the monetary union. Private actors – pension funds – played an important role in bringing about the reform, in particular in organizing a massive campaign that shifted public opinion on public pension system. First, an 'informative' campaign was organized by the government (financed by the World Bank) and then the private pension funds organized more massive initiatives to encourage citizens to join their respective funds. According to the Slovak daily SME, it was the most expensive advertising campaign since Slovak independence. As a result, almost a third of the population indeed joined the mandatory private pillar.

At the same time, however, the neoliberal government still had to give in to social pressure for a return to a more universal system of family support and, in 2002, it reintroduced the old-style payments. Yet, even here the neoliberal stamp was apparent as family support was now linked with stricter income and work requirements (Inglot, 2009). As Slovak experts themselves observed (in a typically workfarist discourse), the new policy seeks to reconcile the 'motivational aspects of social policy' with efforts to ensure 'flexibility on the labour market' (Stanek et. al., 2007; quoted in Inglot, 2009: 92).

Probably the most controversial part of the welfare reforms were the changes made to the health care system. Under the new legislation, hospitals were expected to eventually operate entirely out of their own revenue and were forced to compete for patients. Patients were, on the other hand, expected to take on greater responsibility through the introduction of numerous co-payment schemes and fees for the health care. In addition, the state-owned insurance companies were transformed into profit-driven joint stock companies, while the insurance market was open for private competitors. However, the reforms were met with strong resistance from health care professionals and the public, thereby preventing an even broader neoliberal package (Fisher et. al, 2007).

Overall, the neoliberal government implemented substantive welfare state retrenchments and privatizations of social services. As a result, while the level of social expenditure remained stable during the first Dzurnda government, hovering around 19% of GDP, between 2002 and 2006 it fell to 16% thereby bringing Slovakia closer to the neoliberal model of the Baltic states. Coupled with radical tax reforms and the lack of any expansion in education and human capital investment, these reforms decisively steered Slovakia on the low-road Competition State model.

Conclusion - explaining the Slovak neoliberal path

Different explanations were proposed in the literature as to how and why Slovakia was able to pass such an extensive and radical overhaul of its welfare state. Some referred to the weakness of its trade unions (Antalova, 2010), others to the weak institutionalization of its political party system (O'Dwyer and Kovalcik, 2007), while a third group of authors highlighted the strength and cohesiveness of the epistemic community in Slovakia and the weakness of the political opposition to the ruling coalition (Fisher and Gould, 2006) and yet others look to the structural pressures of globalization and competition for capital (Drahokoupil, 2009; Appel, 2006). The approach developed here is that the key explanation should be sought in the characteristics of Slovak party system, but rather than simply examining the weak institutionalization, the most important aspect of it is the *content* of Slovak politics, i.e. the axis of competition among political parties. As already argued, structural explanations referring only to the pressures of international financial markets or the race for attracting investments are simply not sufficient to explain differences in the strategies chosen for attracting capital – i.e. the question of why the Slovak Competition State took a form different to that of the Czech Republic. On the other hand, the weakness of trade unions is an important part of the story; however, trade unions in Slovakia are not much weaker than they are in other East European states and, more importantly, in all of them (apart from Slovenia) the strength of trade unions depends primarily on the strength of political parties and the incumbency of the left. In other words, trade unions were more influential in the Czech Republic because the government was left-leaning, rather than because they were able to force the right-wing government to accept policy concessions. However, the weakness of the 'left' in Slovakia – and the associated weakness of the opposition – was itself a result of the absence of the socio-economic cleavage as a basis for the structuring of the party system in Slovakia. There were two main implications of the features of the Slovak political party system: the first was that, as already argued, the Slovak post-communist left party did not survive its experience of governing in the big coalition government of 1998-2002 and thus completely disintegrated after the change of government in 2002. Hence, a party that had placed itself in the anti-Meciarist and pro-democratic camp, and was positioned to the left of the economic and social policy spectrum, simply ceased to exist because of its participation in the anti-Meciarist government. Another implication was that the new party that emerged as the strongest force on the left did not simply define itself as a primarily left party – rather, it adopted more of a 'populist' approach of being 'beyond left and right' instead of presenting a real economic alternative to the neoliberal theories of the political right. Thus, the fact that the pattern of competition among political parties in Slovakia did not foster the emergence of different and competing economic agendas contributed to the fact that neoliberal ideas indeed were the only game in town. Furthermore, thanks to the fact that the neoliberals were the only party that was at the same time decidedly anti-nationalist and pro-European also meant that the votes of the urban and educated population (which in the Czech Republic was predominantly Social Democratic) went largely to the right side of the political spectrum primarily because of their pro-Western and pro-European agenda, rather than because of the programmatic appeal of their neoliberal agenda.

The explanation based on the characteristics of the party systems thus certainly falls in the camp of political, rather than economic or structural, explanations for the Slovak neoliberal strategy of building transnational capitalism. Nevertheless, as opposed to the political theories that focus on the lack of *barriers* to the neoliberal agenda, thus taking for granted that low taxes and a minimalist welfare state are indeed *the* best strategy for attracting FDI and increasing competitiveness, the approach adopted here is that the very existence and predominance of neoliberalism as the most appropriate response to economic globalization has itself to be explained. The comparison with the parallel rise of a different Competition State in the Czech Republic thus shows that a neoliberal minimalist agenda can only flourish in political conditions which are not conducive to the development of competing economic agendas – in other words, in political systems based on predominantly idealistic or second-order politics, rather than on the conflict over socio-economic left-right issues. This has become particularly apparent once the Slovak 'left' got its chance to change the course the country was taking – and it turned out that 'centrist populism' in Slovakia indeed did not have the wherewithal to bring about any alternative to neoliberalism.

Slovak Competition State under populist 'Left'

Introduction

If the 1998 elections were a public plebiscite on Meciar's regime with the record high electoral turnout, then the 2006 elections represented exactly the opposite and actually reflected the disillusionment of the electorate, with only a 55% turnout. The elections handed power to a coalition of nationalist and populist parties headed by 'centrist populist' Smer, which by then had turned closer to the 'left populist' pole, joined by Meciar's HZDS and the extreme nationalist Slovak National Party (SNS). Judging by the debates and promises made in the election campaign, one would have expected that a victory for Fico's Smer would bring radical changes to the Slovakian low-road Competition State. Indeed, Fico's campaign revolved around his criticism of the reforms instigated by the Dzurinda government, his apparent concern for the little people suffering the consequences of these reforms, promises to abolish the uniform VAT rate and to re-introduce progressivity in the tax system, the need to overhaul the pension and health care reforms, and an explicit emphasis on the creation of a knowledge-based society, rather than having Slovakia compete on the basis of its low wage and low cost environment. His main target was the corruption of the previous government, accusing them of obtaining lucrative provisions for themselves while selling the national enterprises, in particular the banks, gas and energy companies, to 'foreign sharks'. Moreover, he also questioned the decision to join the Euro in 2009.

Given the rhetoric and the salience of socio-economic issues in the political debates preceding the elections, if the simple incumbency of the 'left' and 'right' parties was the crucial or the predominant factor explaining the reforms, Slovakia's path should have been radically altered during the period of Fico's government. In reality, however, the changes introduced by this government were rather underwhelming and 'cosmetic' in nature: minor adjustments to the tax system while still maintaining the flat-tax regime; partial and half-hearted attempts at pension reforms that stopped well short of abolishing the mandatory private pillar; somewhat stronger reforms in the health care sector which saw the abolishment of co-payments and the reduction of independence of the Health Care Supervision Authority; as well as some amendments to the Labour Code to reverse its previous extreme flexibility. The government also appeared determined to continue the policy of the 'shrinking state' – in its Convergence program it foresaw a further fall in tax revenues as well as in public expenditure as a share of GDP for the period of 2007 to 2010.

Where the new government *did* seem to reverse the achievements of the previous one was more in the style of governing than in the content of policies. According to Grigorij Meseznikov and the studies published by the Institue of Public Affairs (IVO), Smer's behaviour while in government was in visible contradiction with liberal democratic traditions: quality of democracy, implementation of human and minority rights, treatment of opposition, the transparency of the procedure of changing laws – all of these deteriorated in comparison with the Dzurinda government (Meseznikov, interview). The government also showed itself to be rather adversarial towards the media, journalists and NGOs (Bertelsmann Stiftung, 2010). The undemocratic character of Fico's SMER is precisely the reason why he ended up governing in coalition with SNS and HZDS – he had actually tried to form a coalition with the right-wing parties but SDKU rejected the idea precisely on the grounds of Smer's non-democratic profile. As a result of forming a coalition with the nationalist SNS, Smer was suspended from the Party of European Socialists, though its membership was renewed in the beginning of 2008. Indicatively, the main reason for renewing the membership was the fact that European Socialists had no other potential partner in Slovakia, thus demonstrating again the void at the left pole of the Slovak political spectrum.

Thanks to the lack of any programmatic alternative to the neoliberal agenda, the Smer government thus retained the main features of the Slovak low-road Competition State. At the same time, the Slovak economy started to feel the consequences of the global financial crisis – primarily through the fall of exports and industrial production, rather than a crisis in the financial sector. As Slovak car production was more specialized in higher segments of the car market, it experienced a more severe downfall than the Czech auto-industry, resulting in Slovak GDP in the first quarter of 2009 falling for more than 5% on a yearly basis. The unemployment rate also rose from less than 8% in 2008 to more than 12% in 2009 as companies started to lay workers off, with a full 18% of manufacturing jobs being lost. Furthermore, as the country had just entered Eurozone in 2009 it was, on the one hand, protected from the exchange rate risk but, on the other, it lost significant export competitiveness compared to its neighbours that were not in the Eurozone. Still, the recovery was fairly quick with the 4% GDP growth recorded in 2010, partly also helped by the weakening of the Euro. Contrary to the Czech centre-right government's response to the crisis, the Slovak 'left' government turned to expansionary measures rather than further social cuts, primarily embarking on large public investments as well as adopting various business support measures. Despite increasing the level of public investment, the government left taxes intact thus leaving a substantive budget deficit – 8% of GDP in 2009, up from 2% only a year earlier. As opposed to the Slovak's low-road Competition State counterpart Ireland, this however did not come about due to large bank bailouts simply because the Slovak banking system was largely owned by foreign banks and remained more resilient in the crisis. Hence, while rolling out large public investment projects, the government did not change its basic strategy for fostering private investment through low taxes, ending up with a large budget deficit. The elections in 2010 actually confirmed the popularity of SMER which emerged as the electoral victor; however, since its coalition partners recorded much worse results, the overall majority in the parliament went back to the right-wing parties. Once again, the lines among parties shaping the pattern of coalition building held firm and, as the right wing parties were not willing to cooperate with Fico, a SDKU-led coalition formed the government in 2010. Its highest priority was to reduce the budget deficit through a reduction in public expenditure and a simultaneous increase of VAT, as well as implementing reforms to the social security system and labour law, hence promising to bring yet another decisively neoliberal turn to Slovak policy making. As the incumbency of the populist left failed to bring about a change of the basic course the country was taking, up until 2010 Slovakia remained in the low-road Competition State camp.

Economic policy of the populist left

After the neoliberal reforms in 2004, and Smer's re-launch as a 'Social Democratic' party that was critical of the reforms, politics in Slovakia in the 2006 and 2010 elections indeed turned out to shift towards socio-economic left-right issues. Surveys show that the average correlation between support for individual parties and national questions fell between 1999 and 2006, whereas the correlation with economic questions (state vs. personal responsibility) increased from 0.08 to 0.15 (Rybar, 2007). The expert survey of Rohrschneider and Whitefield also shows that the experts saw the questions of nation and democracy declining from 2003 to 2007, while economic questions maintained their importance, thus becoming the front line of the political divide (Rohrschneider and Whitefield, 2009). Nevertheless, this still did not lead to the emergence of a programmatic alternative to neoliberal policies, as Smer offered criticism but very little innovation and fell well short of presenting a coherent economic program. The fact that Fico tried to build coalition with the right-wing parties also points to the fact that the left side of the political spectrum remained fairly empty in Slovakia. While Smer's election program in 2006 promised more solidarity and a stronger welfare state, it did not offer anything substantively new in its ideas on how to achieve this economic growth that should then be redistributed in a more just way. As opposed to CSSD, for instance, in the section on investment incentives Smer turned out to be quite critical, arguing for more transparency in awarding state aid, more focus on domestic investors and stricter requirements for investors to prove that their projects would really bring added value to the region (Smer, 2006). Thus, investment incentives were primarily seen in a negative light while, on the other hand, the government promised to maintain the corporate income tax rate of 19 % (the lowest in the region at the time) introduced by Dzurinda. Similarly, with regards to pensions, the second pillar was there to stay; and only in health policy did Smer promise more changes. With respect to labour market policy, the presence of flexibility was acknowledged to be of utmost importance for economic growth, while work-incentives for the population were to be maintained by using public works and ensuring that persons receiving unemployment benefits fulfilled certain participation requirements (Smer, 2006). In short, other than paying lip-service to the goals of social solidarity and promising to redistribute the gains of economic growth more equally, Smer did not promise any *new* strategy for increasing economic growth. It is true also that, at that time, Slovakia was experiencing exceptional economic growth so that it would be difficult to blame the reforms of the previous government for failing to deliver such growth. Still, the important point is that no different economic vision was offered so that, in terms of programmatic statements, Slovak citizens could indeed choose between pure neoliberalism and neoliberalism with a human face. No wonder then that the basic contours of the Slovak minimalist Competition State remained the same after the change in government in 2006.

With respect to investment incentives, the new government changed the law in favour of giving more opportunities to domestic enterprises to apply for investment subsidies – thus making concessions to the domestic business lobby that had protested against the discriminatory practice of the previous government. On the other hand, the generosity of the subsidies granted to foreign investors actually decreased, as did horizontal state aid. Slovakia still landed some major investments in 2007, but not much after that – and not only due to the crisis, but also because the new administration did not pay much attention to attracting foreigners. Thus – and in contrast with the Czech left-wing incumbency - Fico's government actually cemented Slovakia's low-road path since, in the absence of generous subsidies, the only remaining elements of Slovakian attractiveness were its low tax and low cost environment. Kučera recalls how the situation in SARIO changed dramatically in 2007: '*Based on their fight against investment incentives, Smer was certainly emphasising that there would be no disadvantages for domestic business and that the state* *should support domestic investment. This of course meant that the role of SARIO decreased in the upcoming years. Moreover, Smer took the control of the Ministry of Economy, while SNS appointed the CEO of SARIO and all the tensions that existed between coalition partners in general were translated into tensions between the Ministry and SARIO. Because SARIO was totally dependent on the Ministry of Economy, basically it was an extension of the Ministry, this created a difficult situation for SARIO. There were many conflicts between SARIO and the Ministry, there was no coordination of representation, most negotiations with investors at the time were conducted separately so the investors would meet SARIO people who would tell him something, then he would meet the people from the Ministry who would tell him something completely different so it did not help.*' (Kučera, interview). The strained relations between the Ministry and SARIO also led to a reduction of the budget for a substantial campaign or promotional seminars abroad. '*By reducing the budget and by the dis-alignment between SARIO and the Ministry, which in the end was the main authority granting the incentives, SARIO was not able to offer that much value to investors. There were no campaigns, no seminars and no help to investors since the investment project was not agreed with SARIO even if FDI came to the country.*' (Kučera, interview).

The attitude of supporting domestic business rather than trying to attract foreign ones was also reflected in the governance of SARIO, where during Fico government the best resourced part of the agency was the part in charge of the support of domestic exporters rather than FDI (Balintova, interview). Hence, similar to the change of government in the Czech Republic which led to the return of a party associated with national entrepreneurs (which in Czech case was the neoliberal ODS), in Slovakia the shift from a neoliberal administration to a populist left government closer to national business elite also brought about a reorientation of investment support from foreign to domestic investment. However, this shift took place in the context of much lower resources being devoted to investment support in the first place so the Slovak Competition State retained its minimalist form, rather than adopting an activist industrial policy.

The government also maintained the commitment to join Eurozone. Although it flirted with the idea of postponing entry at the beginning of the mandate, the reaction of the financial markets and the rush on Slovak coruna which forced the National Bank to make a costly intervention, quickly made the government change their mind and they proceeded with the scheduled Euro-entry in 2009. Thus, a balanced budget, low public debt and a low inflation rate all had to be maintained within the Maastricht criteria so that the government would not have much space for major changes. In the event, the government had two possible routes to stay within the Maastricht criteria: increase spending, but also increase taxes and thereby maintain a balanced budget; or a implement a low tax and low spending equilibrium – and the Smer government opted for the latter.

Welfare state – frozen neoliberalism

The period of SMER incumbency can thus best be summarized as one of relative stability – the government did not proceed with all the liberal reforms embarked upon by the Dzurinda administration and it briefly stopped the strong neoliberal wave, but nor did it revert any of the previous reforms. This was partly because the main party in government was not strongly opposed to the core of the reforms – for instance, in case of pension privatization they simply wanted to reduce the level of contributions paid to the second private pillar, but not change the entire architecture of the pension system or abolish the mandatory private pillar altogether. The flat-tax regime was also kept in place, despite the strong criticism Fico had directed at the reform while in opposition. With regards to VAT, the only change they introduced was to remove books and medicine from the standard VAT bracket, but food and essentials were still taxed at the 19% rate. The progressivity of taxation was somewhat reinstated by increasing the non-taxable income of the poorest social strata, but this was a move for which the party also got support from the right-wing opposition – not least because the move actually represents a subsidisation of low-wage workers. A degree of continuity with previous policies is apparent also in the personnel changes – or more precisely the lack thereof. Some of the key officials from the period of Dzurinda's government were kept in place. Most importantly, Richard Sulik, the author of the flat-tax reform remained in his post in the Ministry of Finance serving as an advisor to the Smer minister Pociatek in the first year of the new mandate, clearly signalling that the new government was not interested in substantively changing direction in the first place. Although the government campaigned on the promise to make the tax system more progressive, the only way in which this was actually achieved was through lowering the minimum taxable income level for employees who earn more than 1 300 EUR per month – thus making the better-off pay more in taxes since more of their income is taxed, while increasing the minimum taxable income level for low-wage employees.

One of the few changes that the Smer government did make was a reform of the Labour Law in 2007. The new legislation was drafted in close cooperation with the trade unions, who had basically conditioned their pre-election political support for Fico on his being committed to change the ultra-liberal labour law adopted by the previous government. The fate of that reform was not certain as the two coalition parties, HZDS and SNS, were also against the changes to the Labour Law. However, the law was still passed in 2007, soon contributing to a fall in Slovakia's rankings on competitiveness and doing business indexes. The law imposed limits on the use of independent contractors; added overall limits to overtime hours, including reducing permissible compulsory overtime; prevented the repeated use of temporary contracts; raised the notice and compensation periods for laid-off workers, and lowered the threshold for workers who can be fired without cause from 20 hours a week to 15. The new government also restored the tripartite council which was disbanded by the Dzurinda government in 2004.

As regards pension reforms, which were also the object of severe criticism before the elections, the new government created the possibility to return from the private to the public pillar in January 2008 and tried to encourage citizens to change their decision through an information campaign which focused on the risks of speculation in the capital market. Overall, however, out of potentially 1.5 million, only 90,000 savers did so. A new period for opting out was initiated in November 2008, with a parallel information campaign, and this time there were additional arguments that the global financial crisis had made it more risky to save in the private sector. However, by the end of the campaign in June 2009, only 8,700 savers had switched back to the PAYG system. The government also reduced the maximum fee that pension funds can charge to their users, as well as introduced a law according to which private funds have to guarantee 100% of the savings of their users, thereby prompting the funds to pursue only conservative investments. Still, this was far from abolishing the mandatory private pillar altogether. Once the privatization of pensions took place and a large share of the population joined the private pillar, this policy also turned out to be difficult to scale back.

The health care reform introduced by the Dzurinda government was one of the most contentious parts of its neoliberal package and it was also the one which the new government tried hardest to reverse. The first step was the abolishment of the health care co-payments scheme and the reduction of the fees for medicine prescriptions. The process of transforming health-care facilities into joint-stock companies was also stopped. Most importantly, the government changed the law on health insurance companies, capping the share of premiums they can use for operating costs at below 4% and forcing insurance companies to reinvest their profits into healthcare services.

Thus, although there were some reversals of the previous reforms, most of them were actually largely preserved. The attempts themselves were, however, not particularly ambitious – for instance, the mandatory private pension pillar was left in place, despite giving the citizens two windows of opportunity to opt-out of it. Other than the labour law changes, other policies actually show that the incumbency of the 'left' did not really bring about substantial changes to the Slovak neoliberal welfare state. Crucially, there were no new policies and no expansion of the welfare state during Fico's term in office – the only exceptions being the introduction of a Christmas bonus for pensioners and an increase in child allowances. In contrast with the Czech social democrats, for example, the Slovak expenditure on active labour market policies or education was not increased, despite the self-proclaimed 'third way' character of Smer. The overall picture is, thus, one of frozen neoliberalism rather than any form of more generous welfare or workfare state building.

Conclusion

The main aim of this chapter was to demonstrate that the Slovakian low-road Competition State, often seen as the best example of the unavoidable fate of policy regimes in small FDI-based economies, actually emerged primarily as a result of political developments in the country. It has been shown that the radical neoliberal policy experiments it enacted were mainly the result of the complete ideational hegemony of neoliberal economic ideas in the political arena, a hegemonic situation which itself was the consequence of the difficult and cumbersome process of the democratization of the country. In the Czech Republic, the shift towards FDI-led development gave rise to competing strategies for attracting FDI and an eventual electoral victory for the social democratic agenda. In Slovakia, meanwhile, the protracted democratization process and the rise of an authoritarian regime in the 1990s steered the political party system away from competing on economic ideas or strategies and towards competition based on political regime issues – which led to a context in which neoliberalism was indeed the only political program associated with externally-oriented strategy. These developments had three main implications for the party system and political landscape in Slovakia: the break-up of the pro-democratic reformed post-communist left party; the electoral success of the neoliberal parties *despite* the lack of popular support for their economic reforms; and the emergence and subsequent success of a centrist populist party despite the fact that the latter did not offer any new or different economic program. Consequently, the radical neoliberal policies enacted by a government whose legitimacy lay primarily in the parties' commitment to democratization and joining the EU were preserved even after a change in government and the rise to power of a coalition led by a leftist-populist party. The need to attract FDI and to boost the country's export competitiveness certainly played an important role in triggering the fall of the Meciar regime, as the rising concerns in the international financial markets made it impossible for that government to continue with its internally-oriented model of national capitalism and galvanised political opposition to the regime. Nevertheless, the exact form of state transformation – and the Slovak strategy of building competitiveness along the lines of a low-tax low-spending 'Tatra tiger' – were primarily the result of a choice by the political elite to adopt a clear-cut neoliberal program that was not seriously challenged from any other corner of the political system.

CONCLUSION

This thesis seeks to answer two main questions pertaining to the role of capitalist states in contemporary transnationalised economy in Europe: first, are European states experiencing a transformation towards becoming Competition States and, secondly, what are the reasons behind the different forms that this transformation can take. In this concluding chapter I will reiterate the main findings of the study and point to its main contributions, as well as to some questions that remain open for future research.

Regarding the first question, the thesis shows that the restructuring of states in line with the propositions of the Competition State theory is indeed evident in some European states, but not in all of them. The first relevant finding of the study is that the overarching fiscal and social policy reforms undertaken with the aim of attracting investments and increasing competitiveness are much more a feature of the states that have retained their national currencies than the states that have pooled their monetary sovereignty in the creation of the European monetary union. Contrary to the widespread expectation that the creation of the Eurozone would force its member states to implement reforms in order to increase competitiveness, the first part of this study shows that monetary integration had precisely the opposite effect as it shielded individual states from the pressures of the international financial markets. While the peripheral members of the Eurozone have relied on privatized Keynesianism and ever-increasing private debt while being able to ignore their mounting current account deficits, the core countries have relied on the increased demand from the periphery as a way of maintaining their growth. Thus, rather than acting as a catalyst prompting countries to transform into Competition States, the creation of the Eurozone actually acted as a buffer by reducing the pressure to transform into Competition States.

Those countries which remained outside the Euro, however, still had to face the same pressures from financial markets and transnationally mobile capital compelling them to revert to competitiveness-oriented policies – and this is precisely what they did. Still, the reforms that they implemented are far from being uniform, leading to the emergence of different types of Competition States depending on a combination of historical legacies and political factors. While in the case of Scandinavian Competition States the reformers were clearly ‘converting’ some elements of the Scandinavian Social Democratic welfare states, redeploying them for new purposes, in the case of East European Competition States the reforms often represented a radical break with the past, but were still far from uniform. Given the specific context of this transnationalisation being undertaken simultaneously to the processes of democratization and capitalism building, the emergence of distinct 'state projects' focused on the goal of increasing competitiveness in the East turned out to be shaped by domestic political struggles. The case-studies of the Czech Republic and Slovakia as two different types of Competition States – a high-road and a low-road variant, respectively – show that it is indeed the characteristics of the domestic political system, in particular the structure of the political party system with its different axis of competition, that shapes the form of the Competition States that are emerging in the region. A high-road Competition State emerged in the Czech Republic as a distinct state project of the Social Democrats, who had managed to secure cross-class support for their program of increasing competitiveness through actively managing the influx of foreign investment and expanding public investment in education and labour market activation. Meanwhile, in Slovakia, a low-road Competition State turned out to be a result of the political program of local neoliberals that faced no alternative economic agenda in the political arena. This lack of alternative is, in turn, attributed to the structuring of the political party system in Slovakia that, due to the protracted democratization process and the reign of a semi-authoritarian regime in the 1990s, developed largely on the basis of competition over political regime issues rather than on socio-economic issues. On the one hand, this made it less likely that an alternative economic agenda, such as a high-road competitiveness strategy, would ever emerge in the political arena and, on the other hand, it also made it easier for the neoliberal parties to secure electoral victory thanks to their positions on *other* issues, rather than on the back of a widespread belief in the *panacea* of neoliberalism.

An important question here is: how far can this argument travel beyond the cases examined in the thesis – i.e., to what extent can the explanations offered in the thesis for the divergent developments in the Czech Republic and Slovakia help explain other cases of different types of Competition States? As the Czech Republic and Slovakia were chosen as representatives of two types, the ambition would be that the explanation of their differences should at least help account for the differentiation of the two clusters of Competition States that they belong to. A glance at other countries in their respective clusters shows that there is indeed basis for believing that a party systems argument is relevant for the other high-road and low-road Competition States. In particular, while the Czech Republic may indeed be somewhat exceptional in Eastern Europe as its party system is almost exclusively focused on socio-economic issues, the other two cases of high-road Competition States in the East – Poland and Hungary – were also marked by predominantly materialist politics in the 1990s and relatively strong post-communist left parties, and neither of them saw their political system shift towards competing on political regime or ethnicity issues, at least up until 2007 while the statistical analysis still classifies them as high-road Competition States. Furthermore, the UK, which is tentatively placed in the high-road cluster, is also an example of a party system which has been traditionally shaped by left-right issues and the opposition between the Conservatives and Labour. There, the political landscape has also seen the reinvention of Labour in the form the Blair-ist Third Way Social Democracy, focusing precisely on activist recommodification and social investment as the core of its political program. On the other hand, low-road Competition States, which are in many respects the embodiment of clear neoliberal blueprints, appear to develop primarily in states that have experienced difficulties in their process of democratization – either due to the predominance of ethnic politics in the Baltics or due to the prolonged semi-authoritarianism in Slovakia, Bulgaria and Romania, all of which have shifted the centre of politics from the conflict over socio-economic issues towards the conflict over political regime or identity issues. As has already been pointed out, the only non-Eastern member of this cluster – Ireland – is a case of a country that has traditionally had a weak socio-economic cleavage and that has developed a party system shaped primarily by national independence issues. Naturally, a broader testing of the argument would require more research and perhaps a different methodology, but the preliminary overview suggests that the characteristics and the dynamics of party systems could help explain the diverse strategies of increasing competitiveness in other states as well.

Another important question pertains to the theoretical implications of the present study: what does it tell us about the usefulness of the concept of Competition State both in relation to the largely theoretical contributions of the literature developing the general theory of state transformations in transnationalised economy, as well as in relation to the conceptualizations more commonly used in comparative political economy. With regards to the first, the findings suggest that rather than thinking about Competition State as a unique ideal-type, empirical reality actually shows different types of Competition States emerging out of different strategies for increasing competitiveness. Hence, plurality rather than a singular form seem to be a more appropriate way of thinking about state transformations driven by the increased competition for capital. With regards to the second issue, i.e. the usefulness of the concept as opposed to the other conceptualizations in comparative political economy, when taken in plurality, the main value added of the concept of Competition State is that it enables one to examine both change over time and variation across space. While the most common classifications in comparative political economy (Varieties of Capitalism as well as different types of welfare state) are better equipped to describe stability, the concept of Competition State is derived from the evolutionary perspective which focuses on examining change and the co-evolution of capitalism and states and hence enables us to capture variety that is different from the variety of states in the period of what Ruggie would call 'embedded liberalism' (Ruggie, 1982). Furthermore, while concepts focusing on institutional complementarity in varieties of capitalism (VoC as well as its adaptation to Eastern Europe in the DME framework) take the perspective of firms as their starting point, Competition State concept takes the perspective of states as the starting point and thus enables a closer examination of the politics of institutional change. Moreover, while the concept of Dependent Market Economies (Nolke and Vliegenthart, 2009) sees the condition of dependency as a common feature and the main determinant of political economies in Central and Eastern Europe, the variety of Competition States found in the present study reveals the variation among different state strategies of managing the situation of economic dependency. In that sense, the dissertation is probably closest to the conceptualization of Polanyian varieties of capitalism as developed by Bohle and Greskovits (2012) - however, while the latter approach tries to understand different ways in which liberalization and commodification were combined with the demands for social protection, the emphasis here is not on liberalization, but rather on increasing competitiveness so that the focus is primarily on different ways in which competitiveness was increased, rather than on different ways in which the same requirements of capitalist profit making were reconciled with the need for political and social integration. This also distinguishes the concept of Competition States from the simple notion of neoliberalization, as it does not start from the dichotomy between states and markets according to which more markets would simply mean *less* states, but rather enables one to examine the coevolution of states and markets and the ways in which changing and more transnationalised markets encounter changing and variegated forms of state rather than simply smaller or 'less capable' states.

One of the limitations of the present study is its time-frame, as the analysis stops precisely at the advent of the Great Recession and the crisis of the Eurozone which has made the problem of competitiveness and the 'competitiveness gap' in Europe more politically salient than ever. Hence, it is perhaps needless to say that the results of the present analysis should certainly not be taken as the arrival at any kind of a final destination in the process of state changes. Indeed, it is the main assumption of the *Regulation* theory - which represents the starting point for the thesis – that both capitalism and capitalist states are undergoing continuous co-evolution and it is most likely that this evolution will proceed at a more rapid pace during times of great economic crisis. Indeed, in the current sovereign debt crisis in the European South, the political concern with competitiveness and the worries about the lack of 'necessary' reforms in the Mediterranean countries seem to be more salient than ever, with proposals going precisely in the direction of the creation of a 'pact for competitiveness'. However, the above analysis also shows that, rather than taking for granted the exact content of this new competitiveness drive, one should examine the politics of the creation of such content and the politics behind the exact competitiveness-oriented reforms that are proposed.

Furthermore, the current crisis has also revealed that neither of the two forms of Competition States identified here represents either a necessary or a sufficient condition for weathering the crisis successfully. Thanks to the rising private debt and the need for a bank bailout, the Irish Competition State has found itself in the same group as the difficult-to-reform Mediterranean countries. Similarly, the faithful pursuit of competitiveness in some of the Eastern European states, of both the high- and low-road type (Hungary, the Baltics), has not prevented them from some of the largest economic recessions they have seen since the transition to capitalism. Interestingly enough, the major European success story whose 'competitiveness' is widely praised these days – Germany – did embark on a process of adding flexibility to its labour market but has otherwise not seen either major tax cuts nor very generous investment incentives. Thus, while the argument that joining the monetary union actually reduced the pressure to implement competitiveness-oriented reforms in the Eurozone states indeed may explain part of the observed divergence in Europe, it would be wrong to assume that competitiveness-oriented reforms would have saved the Southern European periphery from the troubles it is currently experiencing. The lessons from Hungary, the Baltic republics or indeed Ireland clearly point in the opposite direction. While the idea of the Competition State may thus represent a useful heuristic device for analysing contemporary variegated transformations of European states, it seems to be much less useful as a template for policy makers. The question of the extent to which these different strategies for increasing competitiveness have indeed achieved their goal, and helped secure higher living standards and better positioning of a country's economy in the transnational markets, is one that is open for future research.

Nevertheless, one of the important findings of the present study is that, even in the contemporary circumstances of highly integrated and transnationalised economies and powerful international financial markets, national-level politics still *does* matter for the policy choices a country is making and that these choices are indeed not over-determined by the structural pressures of the global markets. To show that politics matters in a country like the US or Germany is certainly a valid finding; however it is perhaps even more relevant to show that politics matters even in small countries that are deeply integrated in transnational markets and have begun their integration from a relatively peripheral position. The cases selected here are, thus, particularly difficult cases for the 'politics matters' argument; nevertheless, the present analysis shows that the argument indeed holds true even in such unlikely conditions. This, however, is not to say that politics is the only thing that matters since national-level political agency does still have to operate within a given set of constraints – and it is not easy, either for policy makers or researchers, to recognize or delineate how big the space for agency within these constraints actually is and where its possibilities lie. Nevertheless, an attempt to do just that is certainly worthwhile – since, in the words of Peter Evans: '*Being too timid to recognize that "barely structurally possible" strategies may be possible is one route to failure; being too stubborn to recognize that certain forms of change are not "historically viable" is the other.*' (Evans, 2009: 319). By analysing different forms of historically viable paths of state transformation, this thesis seeks to make a contribution towards finding that delicate balance between timidity and stubbornness.

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Appendix

Descriptions and Sources of Variables

EPL - Employment Protection Legislation - the average of 3 subindices: a difficulty of hiring index, a rigidity of hours index and a difficulty of redundancy index. All the subindices have several components and assign values between 0 and 100, with higher values indicating more rigid regulation. Source: World Bank *Doing Business 2008 Report*

ALMP – share of expenditure on active labour market policy (active labour market programmes and labour market administration) in total labour market policy in the year 2007. Source: OECD, Social Expenditure Database and Eurostat

Unemployment Benefit generosity – expenditure on passive labour market policies as a share of GDP adjusted for the unemployment rate

Education – total government education spending as percentage of public expenditure (source: Eurostat)

Social expenditure – total social expenditure as a share of GDP; source: OECD and Eurostat

Revenue – total tax revenue as a share of GDP; source: Eurostat

Tax – effective average tax rate on corporate income expressed as a proportion of the net present value of the income stream (excluding the initial cost of the investment). Source: Devereux et. al. (2008)

VAT – share of VAT in total revenues, source: Eurostat

Aid – state aid granted for horizontal objectives as a share of GDP; source: European State Aid Scoreboard

Interviews

Babos, Pavol. Researcher at Comenius University in Bratislava, Faculty of Philosophy, Department of Political Science. Bratislava, August 2011

Balintova, Kristina. Project Manager at SARIO – Slovak Investment Promotion Agency. Bratislava, September 2011

Becker, Joachim. Professor at Vienna University of Economics and Business, Institute for International Economics and Development. Vienna, September 2011

Gregor, Tibor. Executive Director of Klub 500 – Klub Slovenskych Vlastnikov Zamestnavajucich Viac Ako 500 Zamestnancov (Association of Slovak Entrepreneurs' Employing more than 500 Employees)

Havelka, Jan Amos. Former CEO of CzechInvest. Prague, November 2011

Kicina, Robert. Executive Director of Business Alliance of Slovakia. Bratislava, September 2011

Kolesar, Peter. Researcher and consultant on foreign direct investment. Bratislava, August 2011

Kucera, Miro. Former Project Manager at SARIO – Slovak Investment Promotion Agency, Bratislava, September 2011

Lesay, Ivan. Researcher. Slovak Academy of Science. Bratislava, August 2011

Mach, Petr. Executive director of the Centre for Economics and Politics, Prague and former economic advisor to the President of the Czech Republic Vaclav Klaus. Prague, December 2011

Malova, Darina. Professor at Comenius University in Bratislava, Faculty of Philosophy, Department of Political Science. Bratislava, August 2011

Meseznikov Grigorij. Researcher and the President of IVO - Institut pre Verejney Otazky. (Institut for Public Affairs) Bratislava, September 2011

Mladek, Jan. Former Minister of Agriculture and advisor in the Ministry of Finance of the Czech Republic. Prague, November 2011

Polak, Michal. Researcher and journalist. Bratislava, September 2011

Potucek, Martin. Professor at Charles University, Prague, November 2011

Sapak, Matej. Counsellor at the Ministry of Finance, Office of the Plenipotentiary for Knowledge Economy. Bratislava, September 2011

Saxonberg, Steven. Professor. Masaryk University, Department of Social Work and Social Policy. Prague, November 2011

Sirhalova, Martina. Project Manager at Associacia Zamestnavatelskvch Zvazov a Zdruzeni Slovenskej Republiky (Federation of Employers' Associations of the Slovak Republic). Bratislava, September 2011

Tomes, Igor. Professor. Charles University. Prague, November 2011

Trnik, Michal. Researcher on investment promotion agencies in Czech Republic and Slovakia. Skype interview, September 2011

Ungerman, Jaroslav. Economic advisor in the Czech Social Democratic Party (CSSD). Prague, November 2011

Vecernik, Jiri. Senior Fellow. Institute of Sociology of the Academy of Sciences of the Czech Republic. Prague, November 2011

Zeman, Milos. Former Prime Minister of the Czech Republic (1998-2002). Prague, November 2011